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## The economic situation in the Economic Commission for Europe region: Europe, North America and the Commonwealth of Independent States in 2009-2010

*Summary*

During 2007-2009, the Economic Commission for Europe (ECE) region experienced its worst financial crisis since the Great Depression of the 1930s; the accompanying economic slowdown during 2008-2010 was the worst since the Second World War. Despite the severity of the financial shock, the aggressive use of monetary and fiscal policy, a relatively high level of economic cooperation among the region's Governments, and assistance from international and regional financial institutions allowed the crisis to be contained. Fifteen of the region's economies were forced to turn to the International Monetary Fund for some form of assistance. A slow to moderate recovery is forecast for 2010 but most of the region's economies will not return to their 2008 income levels until 2011 or 2012. However, several of the most affected economies will continue to experience further declines in gross domestic product (GDP) in 2010. Unemployment, which reached 10 per cent in much of the region, may remain above trend through 2014. The fiscal budget and debt situation of the region's advanced economies has deteriorated considerably and in some cases has become problematic.

The ECE region has accounted for over one half of world economic output (on a purchasing power parity basis) for over a century. However, in 2010 its share of world GDP is expected to fall below 50 per cent, owing to the more rapid growth in the developing economies. As recently as 2000, the European Union and North America each accounted for over a quarter of world output and the European emerging economies of Eastern and Southern Europe, the Caucasus, and Central Asia accounted for another 5 per cent. The world share of the European Union and North

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America has now declined to just over a fifth each, while that of the European emerging economies has increased to 6 per cent. The share of the region in world output is expected to continue to decline in the coming decade as its growth in population and per capita income are below world averages.

The ECE region, composed of 56 member States, remains quite diverse. Although it contains most of the world's advanced economies, 26 (or almost one half) of its member States have a per capita income below twice the world average, while 12 of these are below the world average and 5 of these are below one half of the world average. Nine of its economies are considered as United Nations landlocked developing countries. Owing to the severity of the economic and financial crisis, a significant number of the Millennium Development Goals in a number of these economies are unlikely to be achieved without a much more focused effort, including a sizable increase in funding.

# I. The overall economic situation

1. Of the five United Nations regions as defined by the regional commissions, the Economic Commission for Europe (ECE) region was the most negatively impacted by the financial crisis. Real growth for the region declined from 3.2 per cent in 2007 to 1.2 per cent in 2008 to minus 3.6 per cent in 2009. The current forecast is for growth of 2.3 per cent in 2010 and 2.6 per cent in 2011. However, 11 or about one fifth of the region's economies, are expected to have negative growth again in 2010.

2. Of the three subregions of ECE, the decline in gross domestic product (GDP) growth was the largest in the European emerging economies both in terms of its actual level in 2009, which was minus 6.4 per cent, and in terms of the decline relative to recent historical experience; the growth rate in 2009 was minus 13.7 percentage points less than the five-year average of 2003 to 2007. Western and central Europe (which includes the European Union new member States) had a growth rate of minus 3.9 per cent in 2009, which represented a change of minus 6.5 percentage points from 2003 to 2007. In terms of GDP, North America was the least impacted ECE subregion, with growth of minus 2.4 per cent in 2009 and a decline of minus 5.2 percentage points from the 2003-2007 average. Despite the fact that the emerging economies were the most severely affected subregion, eight of them had positive growth in 2009; Poland was the only remaining ECE economy in the other two subregions (and the only European Union economy) to have positive growth in 2009.

3. Despite the severe economic downturn during the crisis, political and social stability were maintained throughout the region, unlike the situation that developed in the 1930s. This was due importantly to the well-developed social safety nets that have been created in those economies.

4. The economic recovery for the region in 2010 and 2011 is forecast to be moderate owing to the effects unemployment will have on constraining consumer expenditures, the need for Governments to withdraw fiscal stimuli prematurely in some cases because of increasing debt levels, and owing to the fact that the financial systems in these economies remain partially impaired because of their need to recapitalize and deleverage. Growth for the European emerging economies is likely to be stronger as they bounce back from steeper declines; the outlook for these economies is especially sensitive to global economic developments. Considerable uncertainty surrounds the potential impact of an extended series of eruptions of the Eyjafjallajokull volcano.

# II. Economic situation in the advanced ECE economies

5. Both the United States of America and Europe experienced a severe financial shock; although it is difficult to quantify the size of this shock for comparative purposes, the United States shock was certainly equal to or greater than that for Western Europe. Nevertheless the economic downturn was smaller in the United States and the recovery has been more rapid. This was due largely to the much more aggressive policy response of the United States both in terms of monetary and fiscal policy. One of the key lessons to come out of the crisis has been to emphasize the importance and effectiveness of discretionary macroeconomic policy. However, there are long-run implications of having a more aggressive macroeconomic policy

in terms of potential inflation and debt repayment difficulties, and only after several more years will it be possible to fully evaluate whether the greater macroeconomic response of the United States was preferable to the more cautious European approach. In addition, some of the difference in the policy stances may have been the result of differences in the structural characteristics of the two regions.

6. Although the Canadian economy largely avoided any financial crisis owing to its better regulatory framework, it nevertheless experienced an economic downturn similar to that in the United States owing to extensive trade and financial linkages with the United States; quarterly growth in the two economies has closely tracked each other for the last several years.

7. Interest rates in the advanced ECE economies remained at or below 1 per cent through most of 2009 and the first half of 2010; in addition, the central banks maintained extraordinary measures (i.e., quantitative easing or some variation of it) to ensure sufficient levels of liquidity. Between mid-2007 and the beginning of 2010, the balance sheet of the United States Federal Reserve increased by more than 150 per cent while that of the European Central Bank increased by 50 per cent. In terms of discretionary fiscal stimulus, the United States implemented a programme equivalent to 6.8 per cent of GDP while the aggregate eurozone package was 2.5 per cent of GDP and the package in the United Kingdom of Great Britain and Northern Ireland was 1.4 per cent of its GDP. However, Europe is estimated to have significantly larger automatic stabilizers. Using the deterioration (from 2007) in the fiscal position as a proxy for the overall fiscal stimulus, the United States and the United Kingdom had a stimulus of 10 per cent of GDP in 2009, while that of the eurozone was 6 per cent.

8. An important factor in limiting the scale of the economic downturn was the extensive use of increased fiscal deficits. Fiscal deficits in a number of the ECE economies are projected to be in double digits in 2010. This includes the United Kingdom (13.5 per cent of GDP), Spain (11.6), the United States (11.1), and Ireland (11.0); the Greek deficit is forecast to be 9.5 per cent of GDP. The timing and composition of the packages varied as some types of spending proved to be more stimulative than others. For example, the United States implemented a massive $787 billion stimulus programme in early 2009, but only 34 per cent of it was actually spent in 2009, while most of the remaining is being spent in 2010; it was composed of infrastructure investment (30 per cent), tax cuts (30 per cent) and transfers to local and state governments and benefit increases (40 per cent).

9. However, as a result, the debt levels increased significantly in most of the advanced economies in the region. By 2014 the major economies will have debt-to-GDP percentages close to 100 per cent. More specifically, the debt-to-GDP ratio is forecast to be 1.29 for Italy, 1.08 for the United States, 0.98 for the UK, 0.96 for France and 0.89 for Germany. The situation has been aggravated by the fact that those economies were running deficits during the boom years prior to the crisis and they face a long-run demographic ageing problem where the provision of pensions and medical care for the retired will negatively affect the budget situation.

10. Although addressing the debt problem will become an important objective of economic policy in those economies in the coming decade, a premature withdrawal of the expansionary fiscal policy before the private sector is able to fully compensate will lengthen the economic downturn and could result in an even worse debt situation. Thus from a policy perspective, what is required is the need for those

economies to design and credibly commit to a long-run plan that addresses the fiscal imbalance but the spending cuts and/or tax increases should not actually be implemented until the economic recovery is complete, which may not occur until the second half of 2011.

11. Poland was the only European Union country to avoid negative growth in 2009. This was due to the fact that it minimized vulnerabilities prior to the crisis by having a flexible exchange rates, limited its current account deficit, controlled credit growth and foreign currency loans. An additional significant factor was its expansionary fiscal policy, which increased the deficit from less than 2 per cent of GDP in 2007 to almost 7 per cent in 2009. However, current projections suggest that it will exceed its legal limit on the size of its public debt by 2014, so some consolidation is likely after 2012.

12. The economic crisis exposed some fundamental weaknesses in the institutional design of the European Union and in particular in the design of the eurozone. At the most general level, economic coordination among its members proved inadequate for crisis management and there appears to be no adequate mechanism to address large current account imbalances within the eurozone. The difficulties faced by the Baltic economies (whose currencies are fixed to the euro) and Greece have revealed significant downsides to being in the eurozone.

13. Global imbalances are considered to be one of the root causes of the economic crisis. The United States current account deficit exceeded 6 per cent of GDP during 2006 but has declined to 3 per cent of GDP at the end of 2009. The uneven recovery, whereby the developing economies, including especially China, have grown much faster in 2009 and 2010 than the United States, has had the desirable effect of keeping global imbalances from returning to their levels prior to the crisis. However, once a global recovery is fully achieved, it is likely that imbalances, and the vulnerabilities they create, will return to undesirable and unsustainable levels if not properly addressed with exchange rate adjustments.

## III. Economic situation in European emerging economies

14. Residents and financial institutions in the European emerging economies owned few of the subprime assets at the heart of the global financial crisis; instead their vulnerability resulted from large declines in exports owing to the significant declines in GDP in their major trading partners, a rapid fall-off in remittances, the collapse in the price of commodities, but most importantly from their dependence on external capital markets for financing their economic development. Many of them experienced a classic "sudden stop" once capital markets froze after the bankruptcy of Lehman Brothers. One vulnerability which these economies did not have, that is often associated with a sudden stop of this type, was a fiscal budget deficit; the external borrowing had been largely undertaken by the private financial sector.

15. There was considerable variation in the performance of the European emerging economies; South-East Europe (minus 3.1 per cent) did better than the Commonwealth of Independent States (CIS) (minus 7.0 per cent). Within South-East Europe, Turkey (minus 5.6 per cent) experienced a larger decline than the others (minus 3.1 per cent). Two of the CIS countries, Armenia and Ukraine, experienced double-digit GDP declines in 2009, while the Central Asian CIS economies, especially those with energy resources and limited exposure to foreign capital

markets, did relatively well. In fact three of those economies — Azerbaijan, Uzbekistan and Turkmenistan — had growth over 6 per cent in 2009 and are forecast to be among the fastest growing economies in the world in 2010. The Russian Federation experienced the largest slowdown of any of the Group of Twenty (G20) economies.

16. The crisis was particularly acute in many of the former transition economies (including the new member States) and was greater than that experienced in much of the CIS after the Russian crisis of 1998/99. Nevertheless the GDP declines during the 2009 crisis were only a fraction of the declines suffered by those economies during the 1990s transition recession. Even in Latvia, which has been the hardest hit economy in the region, the economic decline, which is forecast to be about minus 27 per cent of GDP over the period 2007-2010 is only about one half of what it experienced during the 1990s, nevertheless its economic decline has been large as it is roughly similar to the economic decline experienced by the United States during the Great Depression of the 1930s (which was -29 per cent).

17. Unlike emerging markets during typical economic crises, the European emerging economies were generally able to implement quite large macroeconomic stimulus packages, especially fiscal expansions. The ability to use expansionary monetary policy was more constrained because of exchange market considerations. Social spending was generally maintained or even increased while significant funds were committed to rescue the ailing banking sectors.

18. Those economies with large sovereign wealth funds were also able to use these resources to mitigate the impact of the crisis. Azerbaijan, Kazakhstan, and the Russian Federation had funds going into the crisis equal to 23.6, 20.6, and 15.9 per cent of GDP, respectively. However, uncertainty over the length and severity of the crisis resulted in countries being somewhat conservative in their use. Although there was no legal obligation to do so, a reluctance to commit these funds towards supporting the private sector in addressing their external debts further increased uncertainty and further reduced the private sector's ability to access funds on global capital markets during the crisis.

19. All of the CIS economies are expected to have positive growth in 2010, although the average rate of 3.9 per cent is likely to be significantly below the trend level obtained during the period 2002-2007. The banking sectors remain impaired in several of the larger economies and that will limit investment in the near term. The return of relatively high energy prices is likely to boost growth in the energy-rich economies although currency appreciation in some of them could limit growth and harm diversification efforts; the Russian rouble was at a 14-month high in March 2010. Inflationary concerns may return to some of those economies with the strongest growth, although currency appreciation may limit this to a degree. Growth should increase further in 2011 with a forecast rate of 4.7 per cent. However, further economic diversification and institutional reform will be necessary for restoring robust economic growth in the medium term.

# IV. Specific economic trends

## A. Employment

20. Because of the global crisis, unemployment rose in most of the ECE economies throughout 2009 but appears to have stabilized in the early part of 2010; in the United States and the European Union, the rate peaked at slightly over 10 per cent. In the first quarter of 2010, the rate remains above 15 per cent in Estonia, Georgia, Latvia, Serbia and Spain and above 30 per cent in Bosnia and Herzegovina and the former Yugoslav Republic of Macedonia. The forecast is that the unemployment rates in most of the ECE region will remain above trend for another three to four years.

21. Given the declines in GDP that did occur, the declines in employment were greater than what would be expected in the United States and smaller than expected in Western Europe. Thus, although the decline in GDP was lower in the United States than in the eurozone, unemployment increased more in the former. This was due largely to the differences in labour market flexibility between the subregions. However, some European countries such as Germany, Italy and the Netherlands implemented a number of emergency or short-term labour market policies whose intent was to minimize job losses and a number of those policies proved to be quite successful. For instance, Germany experienced little change in unemployment as the rate in the spring of 2010 was similar to the rate two years earlier.

22. The United States economy lost 8.4 million jobs (or 6.1 per cent of the non-farm payroll) during the current economic downturn, which as a percentage of total employment was the largest of any recession since the Second World War. By the beginning of 2010, over 15 million people were jobless as the unemployment rate increased to just over 10 per cent. This was below the rate in the 1981/82 recession because unemployment had been quite low prior to the beginning of the current crisis. In early 2010, over 11 million people were collecting unemployment benefits. The underemployment rate, which includes discouraged and part-time workers wanting full-time work, peaked at over 17 per cent. The medium duration of unemployment increased from 8.8 weeks in February 2007 to 19.6 weeks in February 2010. The number of workers who were out of work for six months or more, which reached 6.3 million in January 2010, was twice the number previously recorded at any time in the last 50 years.

23. The increase in unemployment in the United States was geographically widespread with all 50 states having higher unemployment in December 2009 than a year earlier. About a fifth of the states had unemployment over 10 per cent in early 2010. Owing largely to the fact that during this downturn, the United States employment declines were much larger than what would be expected given the output declines, the level of productivity increased substantially. In the final quarter of 2009, productivity was 5.8 per cent above the level of a year earlier and as a result unit labour costs were down 4.7 per cent (year over year), which was the largest yearly decline since that statistic began to be calculated in 1948.

24. The annual unemployment rate in the 27-member European Union for 2009 was 8.9 per cent; although rather high, the European Union has had relatively high unemployment for a considerable period of time. For example, the European Union annual unemployment rate was at or above 8.9 per cent between 2002 and 2005. The

rate for males (9.0 per cent) was slightly above that for females (8.8 per cent). However, the employment losses in much of Europe were primarily for men; for example, in Germany 220,000 of the 230,000 jobs lost during the crisis through 2009 were men's jobs. Unemployment in Europe continued to increase in the early part of 2010. In February 2010, unemployment was 9.6 per cent in the 27-member European Union (over 23 million workers) and 10.0 per cent in the eurozone, the latter being the highest rate since August of 1998. The unemployment rate for youth in the 27-member European Union was over 20 per cent in early 2010. Total employment fell 1.9 per cent in the 15-member European Union during 2009.

25. There was significant variation in unemployment in Western Europe (including the new member States), with a 2009 annual rate above 15 per cent in Spain (18 per cent) and Latvia (17.1 per cent) and rates below 5 per cent in the Netherlands (3.4 per cent) and Norway (3.1 per cent). Unemployment was higher in every European Union member State in February 2010 compared with February 2009.

26. Unemployment rates increased in most CIS countries (including in Georgia). Armenia, the Republic of Moldova and Ukraine witnessed a significant deterioration in labour-market indicators. Moreover, the return of migrant workers who had lost jobs in the Russian Federation further increased unemployment, especially in the low-income CIS countries. In early 2010, unemployment in the Russian Federation reached 8.6 per cent and in Kazakhstan, the unemployment rate was 6.5 per cent; the annual unemployment rate for Ukraine was 8.8 per cent in 2009.

## B. Inflation

27. Because of the economic slowdown, inflation has been subdued throughout the region, but by early 2010 it began to increase in a number of economies. Inflation in the advanced economies was considerably below their central banks' general targets of about 2 per cent in 2009. In 2010, inflation should be closer to the target in these economies but may still be marginally below it in the eurozone. Latvia is expected to experience deflation of several per cent during 2010 and that may also happen in some of the highly indebted eurozone economies such as Greece. Inflation has been higher in the European emerging economies, especially in the CIS, where it was about 9 per cent in 2009 and is expected to be about 7 per cent in 2010. Ukraine has had and is expected to continue to have inflation in the low double digits; households in the energy importers are facing higher utility bills as fuel prices become more market-based. In February, inflation reached a double-digit rate of 10.1 per cent in Turkey due to a steep increase in the food index.

28. Monetary growth has been quite low for the advanced economies of the region throughout 2009. In early 2010, the broad money supply in the eurozone was slightly below its level a year earlier while the increases in the United States and the United Kingdom over the same period are below 5 per cent. As a result, anticipated inflation remains low. A potential downside risk concerns the possibility that the higher growth in Asia could cause the commodity price boom of 2007-2008 to return, which might pressure central banks to tighten monetary policy before solid growth is achieved.

## C. Trade

29. A key vulnerability for many of the European emerging economies prior to the crisis was their large current account deficits. The current account deficit was over 10 per cent of GDP for several groupings, including the new member States, South-East Europe (except for Turkey), and the resource-poor CIS in 2008. At the same time, the resource-rich CIS had a current account surplus of almost 15 per cent of GDP. Although the deficits narrowed in 2009 and 2010, especially in the new member States, the deficits remain problematic in much of South-East Europe and the resource-poor CIS.

30. Trade flows declined dramatically throughout the region between the autumn of 2008 and the spring of 2009 owing to the decline in national incomes and to the absence of trade finance. Trade protectionism, which characterized the 1930s crisis, was largely avoided, although attempts by countries to capture the effects of their own fiscal expansions and industry subsidies proved controversial. Global governance of trade, primarily through the disciplines of the World Trade Organization (WTO) proved to be quite successful in containing most forms of protectionism. Within the European Union, restrictions on State aid were severely tested but appear to have worked reasonably well. There were significant exchange-rate movements and generally those that depreciated experienced a smaller reduction in exports. Although a few countries actively used policies to depreciate their currencies, they largely avoided being labelled as protectionist.

31. Trade for the ECE economies, as for much of the world, declined significantly during the crisis especially in the first half of 2009. In 2009, exports of the 27-member European Union declined by 16 per cent, while imports declined by 23 per cent over 2008 levels. There was significant variance with exports from Finland, down by 32 per cent while those of Ireland were down by only 4 per cent. Over a fourth of the European Union had imports that declined by more than 30 per cent in 2009 over 2008 levels. Extra-European Union exports were up 8 per cent in January 2010 from a year before.

32. United States exports of goods and services declined 15 per cent in 2009 over 2008, while imports declined 23 per cent. January 2010 exports were up 15 per cent from a year earlier, while imports were up 12 per cent. Canadian merchandise exports were down 27 per cent in 2009 over 2008, while imports declined 16 per cent. Canadian merchandise exports were up 3 per cent in January from the year before, while imports were down 4 per cent.

33. In January 2010, exports of the CIS countries (and Georgia) were 45 per cent above their level of one year earlier, while imports were 11 per cent higher. Russian exports and imports had declined by approximately 50 per cent between the first half of 2008 and the first half of 2009. CIS countries have succeeded to some degree in diversifying their trade geographically. For none of the CIS countries do a majority of their exports go to the other CIS economies, but several of the CIS countries get more than one half of their imports from the rest of the CIS.

34. Most of the major economies that remain outside WTO are European emerging economies. The failure to obtain WTO accession for the 10 former transition economies has hindered their ability to diversify their exports into higher-value manufacturing and create more dynamic economies. Although the new member States and to some degree South-East Europe have been successful in promoting

regional economic integration, the CIS economies have encountered more problems. Progress in creating a customs union by the members of the Eurasian Economic Community has been limited.

35. The Russian Federation, Belarus and Kazakhstan have continued to advance their aim of establishing a customs union. This will likely require significant tariff reductions by the Russian Federation, which had higher tariffs than the other two countries. The creation of a customs union involves a number of complex institutional adjustments since each of these economies has a significant number of bilateral trade agreements which will need to be harmonized and each is still in the process of acceding to WTO.

## D. Capital and remittance flows

36. During the period 2000-2008, the European emerging economies were receiving very large net capital inflows and those were quite significant in contributing to the strong growth of that period. Those external inflows allowed these economies to achieve investment rates much higher than would have been possible otherwise. Net inflows of capital to these economies, which had reached over 8 per cent of GDP prior to the crisis, were over twice the percentage level for other developing areas, including even fast-growing Asia. In 2006 and 2007, the CIS also had capital inflows greater than in any other major developing world region. However, th.s reliance on external capital proved to be the most important underlying factor that caused the region to experience the economic crisis of 2007-2010 to a greater degree than any other region of the world economy.

37. During the crisis, net capital inflows into emerging Europe (including the new member States) fell from almost 8 per cent of GDP in the years prior to the crisis to near zero in 2009. Portfolio debt and equity and bank loans proved to be particularly volatile with net inflows of over minus 4 per cent of GDP in 2009. Even countries such as the Russian Federation that were net capital exporters had their private financial sectors lose access to global capital markets and this proved to be highly disruptive. Foreign direct investment was more stable but still declined to about half of its pre-crisis level; foreign direct investment had been over $100 billion during 2007 and 2008, but declined to only about $50 billion in 2009. Although official flows were quite important in providing temporary and emergency financing, they were able to counteract only a small share of the decline in private inflows. Medium-term forecasts for capital inflows over the next several years are that inflows will be only about half of the pre-crisis level. Thus the basic development model of the region that had relied on external capital to finance a large share of development is no longer a viable model.

38. Many of the European emerging economies are heavily dependent on remittances. Remittances have been greater than 10 per cent of GDP in many of these economies; Tajikistan and the Republic of Moldova have had remittances in some years greater than 30 per cent of GDP, which is the largest of any countries in the world. For many of these economies, remittances are greater than foreign direct investment inflows and official development assistance (ODA) combined. In the CIS, 31 million people have emigrated to work in another country; in nine of the CIS countries, more than 10 per cent of the population has emigrated. Due to the economic crisis, remittances have fallen quite significantly in the range of about

30 per cent. The Russian Federation has been a major host country fo
workers in the region and in the first half of 2009, remittances ou
31 per cent. Given the strong growth prior to the crisis, this represent
19 per cent from trend. The fall in remittance inflows has been a signi
increasing poverty in the Caucasus and Central Asia.

## E. The financial sector

39. As the crisis developed into 2009, it was necessary for the G
many of the region's economies to continue to provide financi
guarantees for their banking sectors. In the United States, 140
approximately 8,000) failed during 2009, which was up from the 2
bankruptcy of Lehman Brothers in September 2008 was the largest in
history). The forecast is for an even greater number of banks to fai
Canadian financial system escaped from the global financial crisis r
their banks had avoided making extensive subprime-type loans a
stricter regulations regarding leverage and securitization.

40. A significant difference between the 2007-2010 financial crisis
1930s or the more limited crises such as the Russian debt crisis of 19
the region's Governments provided large-scale guarantees for the
deposits, and although a number of banks failed, depositors w
protected. In addition, the central banks in the advanced economies
cheap financing, often at close to a zero interest rate, as a means o
liquidity and improving the solvency of their financial system.

41. In the spring of 2010, the financial sectors in the advanced eco
partially impaired. Loan growth has been low but it is unclear if this r
to a lack of demand for loans owing to the economic downturn
unwillingness of banks to supply credit as they attempt to deleverage
of many medium-sized banks in the United States is still to be teste
the bulk of commercial real estate loans, and estimates suggest that a
of those banks are underwater. In Ireland, the Government has had to a
of most of its large banks.

42. Iceland experienced a severe financial crisis as its major banks
many of the depositors in its banks were foreigners, the questi
responsible for compensating depositors revealed the current
European Union cross-border financial regulations. As of the spring
was yet to be an agreement on how the costs of compensating depos
distributed, as 93 per cent of voters rejected an initial proposal that
had made. The Icelandic authorities had poorly regulated its banking
allowed it to grow excessively large; its banks had assets over 10 tim
the country, which was multiple times what is viewed as prudenti
engaged in a number of questionable practices such as making excessi
owners and related-party clients.

43. The banking systems remain impaired in the CIS and credit gr
weak. State assistance was needed for a number of banks in th
economies, especially the Russian Federation and Kazakhstan (tw
largest banks defaulted), where a number of banks failed. The bank los
number of poor governance issues such as a tendency to have made e


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to related-party clients. Despite the financial problems, depositors were largely protected from losses. Non-performing loans have increased in most of the CIS economies, and in some cases such as Ukraine and Kazakhstan are reaching levels that may become problematic. Nominal interest rates remain considerably higher in the European emerging economies relative to the advanced economies; for example, the main Russian central bank rate only declined to 8.5 per cent in 2010 after 12 rate cuts over the previous year.

44. There was considerable concern about how the high level of foreign bank presence in many of the new member States and the European emerging economies would affect their stability during the crisis. However, foreign ownership generally proved to be a stabilizing force as none pulled out of the region entirely and the only one that failed was Parex Bank in Latvia.

45. Financial sector reform to avoid a repeat of the 2007-2009 crisis is proceeding in the region on many fronts and at different speeds, depending on the issue. However, concerns about regulatory arbitrage have limited the scope for national action and have tended to weaken reforms as countries have proven to be quite sensitive about lowering the international competitiveness of their financial industries. The process has emphasized the importance and necessity of intergovernmental cooperation in setting a consistent, if not harmonized, set of regulations. The likely establishment of a European Systemic Risk Board and a European System of Financial Supervisors should improve the oversight of European financial markets and thereby increase their stability. Progress in addressing the issue of how to resolve failing systemically important cross-border banks has been more limited; the Financial Stability Board is expected to provide a set of guidelines. There has been less consensus on how to address the problems of "too big to fail" institutions and pre-emptively limiting global systemic risks.

## F. Housing markets

46. The immediate cause of the financial crisis was the collapse in the value of United States mortgage-backed securities after United States house prices began to fall; the future evolution of United States house prices still has important implications for the resolution of this crisis. By the spring of 2010, United States house prices have declined approximately 30 per cent from their peak in 2006, although they appeared to have stabilized in 2009. However, the elimination of the tax credit for first-time home buyers at the end of April 2010, a continuing high level of foreclosures, and a large stock of unsold houses, and high unemployment suggest that sales and prices may stay weak for some time. United States new home sales fell in February 2010 to an annual rate of 308,000, which was the lowest since records began in 1963; this was down 78 per cent from the peak in July 2005. The inventory of new homes reached 9.2 months at current sales rates, which was about 50 per cent greater than average. Throughout 2008 and 2009, the percentage of mortgage delinquencies continued to increase, reaching almost 10 per cent by the end of 2009; even prime loans had delinquency rates approaching 7 per cent. About 2.8 million homes were foreclosed in 2009 and the forecast is that foreclosures could reach 3 million in 2010. In the spring of 2010, approximately 12 million mortgages, or about a quarter of mortgages, were underwater.

47. Overall European house prices appreciated even more than those in the United States in the decade prior to the crisis but have declined far less since the crisis began. However, in a few of the worse-hit economies, including Ireland, Latvia, and Spain, house prices have declined significantly and this has contributed to the reduced solvency of their domestic banks. In some European economies, even ones that have experienced significant economic downturns such as the United Kingdom, house prices have remained firm; in the United Kingdom, prices in March 2010 were 9.0 per cent higher than the year before. The possibility that European house prices may still be overvalued remains and this poses a downside risk for Europe's economic recovery. Owing to the recent change in ownership structure and limited historical data, it is more difficult to access house price levels in the European emerging economies.

## G. Emerging debt problems

48. Current debt levels and projected future levels increased substantially in Western Europe owing to the crisis-induced fiscal expansions, which have come on top of debt resulting from longer run demographic developments. In 2009, 13 of the 27 members of the European Union had a debt level greater than the Maastricht limit of 60 per cent of GDP; this includes the four largest economies — Germany, France, the United Kingdom and Italy. The only new member State to do so was Hungary. In 2009, only 5 of the 27 European Union members had a budget deficit below the Maastricht limit of 3 per cent of GDP; 4 had deficits above 10 per cent, including Greece (13.5 per cent of GDP), Ireland (12.5), the United Kingdom (12.1) and Spain (11.2). The eurozone is projected to have a general government fiscal deficit of 7 per cent of GDP in 2010.

49. Concerns about the sustainability of Government deficits in Greece (and to a lesser degree in Portugal and Spain) created a minor sovereign debt crisis. Greek yields on 10-year bonds rose to 7.5 per cent in early 2010, with a spread of 4 per cent over equivalent German bonds; this was the largest spread since 1998, which was before Greece joined the eurozone. Currently Greek debt to GDP is approximately 114 per cent, with a forecast that this will be over 150 per cent by 2012. At current interest rates, the interest cost just to service that debt would amount to 9 per cent of GDP. Approximately 80 per cent of Greek debt is foreign owned. The interest spread was also over 3 per cent in Hungary and over 2 per cent in Poland; it was approximately 1.5 per cent for Portugal and Ireland.

50. Ireland, the United Kingdom and the United States also have similar deficit levels (about 12 per cent in 2009), although somewhat lower debt (about 80 per cent of GDP), but the interest spread on their sovereign debt has remained stable. This is due to varying factors; for the United Kingdom and the United States the central banks or Government agencies purchased much of their Government debt, their central banks can print the currency in which the debt is denominated, and their default risks are viewed to be much lower. However, private debt levels in the United Kingdom are extremely high and, as a result, the United Kingdom total public and private sector debt has reached 380 per cent of GDP, which is the second highest in the world after Japan.

51. The implied probability of a default by Greece over the next five years based upon the price of its credit default swaps reached over 25 per cent in the spring of

2010. A default by Greece would have serious ramifications not only for Europe but for the world economy. A Greek default would be the largest sovereign default since the Second World War. By comparison, Greek debt is now approximately $375 billion, while Argentina defaulted on only $100 billion in 2001 and the Russian Federation defaulted on $70 billion in 1998. A default by Greece would likely create sovereign debt problems for several other economies such as Spain and Portugal. Forecasting models estimate that a default by Greece would lower the growth rate of the entire eurozone by 1 percentage point for the next three years and lower world growth by one half a percentage point for the next three years. The European emerging economies, which are especially dependent on capital inflows, would be particularly negatively impacted by a Greek default.

52. It is widely recognized that a default by Greece would represent a serious European policy failure. The European Union and the International Monetary Fund (IMF) agreed on a joint assistance programme; the European Union Governments agreed to provide up to €30 billion in bilateral loans at below market interest rates, with the expectation that IMF would provide another €15 billion; however, even that sum may prove to be inadequate given the potential needs. The potential for a crisis was also partially diminished when the European Central Bank reversed its decision on reverting to its pre-crisis minimum credit rating for acceptable collateral; without that change, Greek bank liquidity and solvency would have been further reduced.

53. Although ensuring continuing financing for heavily indebted Governments such as Greece is the most immediate concern, the longer-run adjustments in terms of budget retrenchment and real exchange rate depreciation that will be needed in these economies are substantial. For example, Greece has already increased national sales and excise taxes, cut public sector bonuses and frozen pensions. Greece proposes to reduce its fiscal deficit from over 13 per cent of GDP in 2009 to 3 per cent by 2012, and it is estimated that a price deflation of 20 per cent will be required to adjust its real exchange rate. As a result, these high-debt economies face significant spending cuts, higher taxes and most likely wage and price deflation for years. Even if these adjustments can be made, which is somewhat problematic, economic growth in these economies is likely to be low or below trend for an extended period of time.

## V. Multilateral crisis support

54. Fifteen of the ECE economies turned to IMF for varying degrees of assistance during the recent crisis. This included several countries in each of the subregions; it included two of the advanced economies, four of the new member States, seven in the CIS and two in South-East Europe. Generally the packages were on the order of 5 to 10 per cent of GDP of the recipient economy, but some countries such as Poland only requested a contingent Flexible Credit Line, which it did not need to access. Tajikistan obtained IMF resources through a three-year Poverty Reduction and Growth Facility, and Kyrgyzstan was given access to the Exogenous Shocks Facility. Overall, IMF has provided over $80 billion in support for the European economies (not including Greece). There was significant cooperation between IMF and the European Union in designing and funding programmes for the European Union members. The decision by the G20 to quadruple the resources of IMF in the spring of 2009 was a critical turning point in the evolution of this crisis and helped to stabilize the region at an especially critical moment.

55. The conditionality that IMF required during this crisis was considerably less stringent than what has been required during previous crises. Generally the recipient countries were given a greater degree of flexibility in maintaining some macroeconomic stimulus than had normally been the case and their programmes were often adjusted as the global economic situation deteriorated. However, IMF programmes in some economies such as Ukraine had to be put on hold after failing to meet fiscal retrenchment targets. Turkey was unwilling to accept IMF conditions on its fiscal policy and withdrew from negotiations for a standby loan.

56. The financial sector in the new member States and the European emerging economies benefited considerably from the support of the European Bank for Reconstruction and Development (EBRD) and the World Bank. Overall, EBRD increased its investments by 55 per cent in 2009 to $10.7 billion; this higher level of activity is expected to persist through 2010. The European Investment Bank also provided significant loans for specific projects, especially in the new member States.

## VI. Achieving the Millennium Development Goals

57. The Millennium Development Goals remain quite relevant for the region; a significant share of the populations of many of the emerging economies are living in poverty and have inadequate access to health resources, whether it is for maternal or child care or access to treatment for tuberculosis or HIV/AIDS. Although there is still room for significant improvement, the European emerging economies have established relatively good educational systems and have come close to achieving gender equality in them. However, the broader gender issues regarding the workplace and political systems, along with a number of environmental challenges, are a concern for all of the economies in the region, including the most advanced. The advanced economies also have committed to help the developing world to achieve their targets through making the world economic system more development-friendly.

58. Many developing countries do not have the domestic resources that are required for achieving their Millennium Development Goals objectives. The advanced economies that are able to provide this needed financial assistance are primarily located in the ECE region, as those economies provide almost 90 per cent of total ODA provided by the Development Assistance Committee countries. Although the European economies provide a higher percentage of their GDP towards ODA than the other advanced or donor countries, many of them will not meet their 2010 targets. The European Union, which had committed to raise its ODA from 0.35 per cent to 0.59 per cent, will provide only 0.48 per cent in 2010. The United States will meet its 2010 target, although it is lower than the European Union target.

59. The degree to which the indicators incorporated into the Millennium Development Goals have improved or declined over the period 1990-2009 is closely related to the overall economic performance of the particular country during that period. The depth and length of the transitional recession varied quite significantly. Two decades after the transition period began, some of these economies (the energy-rich Central Asian CIS, the central European new member States, and Albania) have increased their national incomes approximately 50 per cent above their 1989 levels,

but many (European CIS, the former States of Yugoslavia in South-East Europe, and the Baltics) have only returned to something similar to the 1989 level, while a few economies (Georgia, the Republic of Moldova, Serbia, Tajikistan, and Ukraine) remain 30 per cent or more below the earlier level. Turkey, which did not have to go through the transition process but still had a severe currency crisis in 1999, has more than doubled its real GDP over this period.

60. The economic crisis has impacted the various Millennium Development Goal indicators through a large number of different channels. The most direct channel has been the effect of increased unemployment on increasing poverty. Much of the progress in poverty reduction made between 2000 and 2008 has been reversed during the economic crisis. Projections suggest that the number of people living in poverty in the region may increase by 50 million between 2008 and 2011. Already, the number of Russians living in poverty has increased from 18.5 million at the end of 2008 to 24.5 million (or 30 per cent) during the first three months of 2009. The increase in unemployment and the fall in wage incomes have reduced the quantity and quality of diets, which has increased hunger and health outcomes, including specifically maternal health, child mortality and the susceptibility towards diseases such as tuberculosis. The increase in poverty is likely to increase risky behaviours such as drug use and prostitution associated with HIV transmission. Lower family incomes in the poorest regions of ECE may result in lower school attendance, as parents cannot afford to send their children to school or may need them to drop out of school in order to work. The deterioration in Government fiscal positions is likely to reduce the provision of social services and lead to cut backs in programmes that address environmental and public health objectives.

61. Given that GDP income levels in many of the European emerging economies may not return to 2008 levels until 2012 and given the high correlation between progress in achieving the Millennium Development Goals and national income growth, the economic crisis is likely to set back progress by four years for a large number of the targets. In other words, many of the Millennium Development Goal indicators in 2015 are likely to be at the levels they would have been in 2011 if the crisis had not occurred.

62. The most important factor that will determine the degree to which the region is able to achieve the Millennium Development Goals by 2015 will be the region's growth rate over the next five years. A return to the vigorous growth of the period 2000-2007 would be a quite important development; that remains problematic, however, given the damage caused by the current economic slowdown to the region's financial systems and Government fiscal positions. Nevertheless within the constraints of national income there are a vast number of policy improvements that could be implemented which could speed up progress on a number of fronts.

# VII. Other major regional developments

63. The United States enacted a major reform of its health-care system in the spring of 2010, although most of the provisions of the reform will not be implemented until 2014. The United States had been spending considerably more on health care than other advanced economies, with no significant improvement in health outcomes; approximately 30 million additional people who had been without health insurance will be covered once the programme becomes operational. The

legislation opens up channels that may allow government-paid health expenditures in the long run to be better contained, which may improve long-run fiscal sustainability.

64. The need for policy reforms to increase the longer-run dynamism and competitiveness of the European economies remains. Most of the objectives set for 2010 in the Lisbon Strategy were not achieved. It is to be replaced by the new Europe 2020 strategy for jobs and growth. It focuses on many of the same objectives such as increasing the employment rate and research and development, improving education, and addressing poverty and climate change.

65. European regional integration continues to increase through both widening and deepening. Estonia appears on track to satisfy the Maastricht criteria for euro accession in 2011 as it, unlike most of the European Union economies, has been able to keep its fiscal deficit below 3 per cent of GDP. Bulgaria is likely to enter the European Union exchange rate mechanism II in the summer of 2010, with a target of joining the eurozone by 2013. Poland has set a target date of 2015 for entry into the eurozone. The fact that several of the new member States had to turn to IMF for external financing may ultimately delay their eventual accession date even if they meet the Maastricht criteria. Agreement to use international arbitration for resolving a border dispute between Slovenia and Croatia has removed the last remaining major obstacle in Croatia's accession process to the European Union and membership is probable by 2012. The remaining countries in South-East Europe either are candidate countries or have Stabilization and Association Agreements. Wider European cooperation and integration is occurring under the institutional framework of the European Union Neighbourhood Policy for the European CIS (excluding the Russian Federation) and the Caucasus.

66. Twelve of the European emerging economies are landlocked, and improving the physical regional transport infrastructure and border and customs procedures remain important objectives for further integrating those economies into the world economy. Recently, significant progress has been made in the development of gas and oil pipelines from those economies to Western Europe and East Asia. The pipelines not only provide additional financial resources for the exporting countries but are important in providing importers greater diversification of suppliers or transport routes, which is able to increase their energy security.

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## Overview of the economic and social conditions in Africa 2010

*Summary*

The global recession negatively affected economic activity in Africa in 2009, but the impact has been milder than initially forecast. Growth in the continental gross domestic product (GDP) decelerated from 4.9 per cent in 2008 to 2.4 per cent in 2009, as demand and prices for African exports, financial flows and remittances to Africa declined (figure I). This was a major turnaround from the relatively high GDP growth sustained over the previous six years. As economic activity slowed down, inflation rates receded, helped also by lower international oil and food prices and by good agricultural harvests in some parts of the continent. Lacklustre economic growth and a benign inflation outlook provided scope for central banks to ease monetary conditions. Fiscal policies were also expansionary in an attempt to cushion the impact of the crisis on poverty levels and to support domestic demand. Yet not all countries had the needed fiscal space for social sector infrastructure and spending, which is required to mitigate the impact of the crisis and support economic diversification.

As economic activity tapered off, the employment situation deteriorated, particularly among vulnerable groups. Poverty either increased or remained high. The predicted impact of the crisis on health and education is grim, and the vulnerable groups are the ones who are most affected. The overall negative impact of the economic crisis on social welfare is likely to compromise progress towards achieving the Millennium Development Goals, especially those aiming to reduce poverty, hunger and maternal and child mortality and to ensure "decent work for all".

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The prospects of achieving the Millennium Development Goals, broader social development and the overall objectives of the New Partnership for Africa's Development (NEPAD) will be compromised if no bold actions are taken to ensure that African countries embark on paths of high, sustainable and employment-focused growth and put social development at the forefront of their development agenda. Robust and sustainable economic growth along with rising economy-wide productivity could be delivered by means of the diversification of production and export bases. Care must therefore be taken to ensure that macroeconomic policies place special attention on real objectives, including economic activity and employment.

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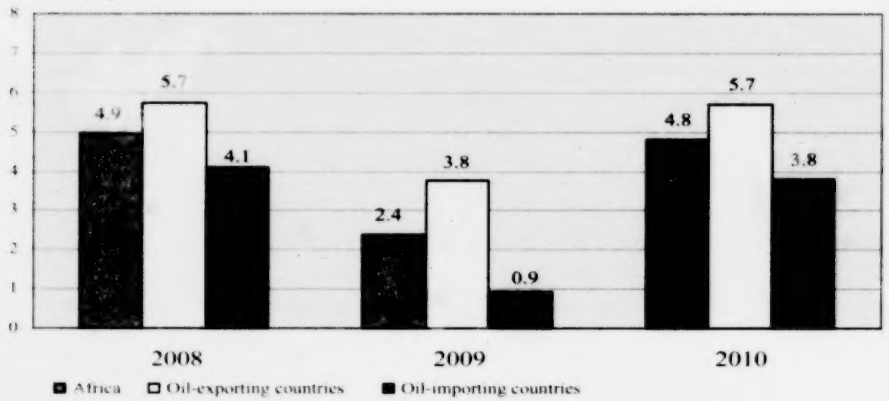
# I. Developments in the global economy

## The world economy contracted and current account widened in 2009

1. The world economy shrank by 2 per cent in 2009, down from the positive, albeit modest, growth rate recorded in 2008, with activity slowing in both developed and developing economies. Despite a significant decline in global trade and capital flows, the world economy has begun to stabilize since the fourth quarter of 2009, supported in large by unprecedented macroeconomic and financial policy measures. In general, developing countries fared better than developed countries. The first group as a whole expanded by 2.2 per cent in 2009, while the second contracted by 3.4 per cent. The aggregate figure for developing countries hides disparities among this group. East and South Asian countries were less affected by the global recession. They posted GDP growth of 4.8 per cent in 2009, while countries in Latin America and the Caribbean experienced the highest contraction in the developing world (-2.1 per cent in 2009 compared with 4 per cent growth in 2008). Current account imbalances in major economies, which were large before the crisis, continued to expand.

Figure I
**Growth in African oil-exporting and oil-importing countries, 2008-2009**
(Percentage)




*Source*: Economic Commission for Africa calculations based on data from the Department of Economic and Social Affairs of the United Nations Secretariat, April 2010.

## Commodity prices plummeted, and so did world trade

2. As global demand fell, the prices of major African export commodities, such as crude petroleum, coffee, cotton and tropical logs, dropped significantly in the first quarter of 2009, particularly when set against their record high levels of mid-2008. However, prices recovered strongly in the following two quarters and are expected to stabilize in 2010. Crude petroleum prices rose on average by 36 per cent above the commodity prices index. The aggregate food price index reached a peak in June 2008, but fell steadily thereafter. By August 2009, the aggregate food price

index had dropped by 77 per cent from its peak level. Prices of all major foods and tropical beverages prices declined, except those of cocoa and sugar. Sugar and cocoa prices rose by about 40 per cent and 5 per cent in 2009, respectively. Continuing their downward trend started in early 2007, the prices of maize and wheat declined in 2009 by 25 per cent for maize and 30 per cent for wheat.

3. In addition to the fall in prices, the volumes of world trade declined in 2009. For example, world exports decreased by 12.4 per cent in terms of volume. Foreign direct investment and remittance inflows to developing countries also declined significantly in 2009.

### A rebound of the world economy, driven by China and India, is expected in 2010

4. Looking ahead, emerging economies, especially China and India, are expected to lead the global economic recovery and to stimulate growth in Africa, directly through increased demand for Africa's commodity exports and capital inflows into Africa as well as indirectly through its positive impact on global commodity prices.

## II. Economic performance in Africa in 2009

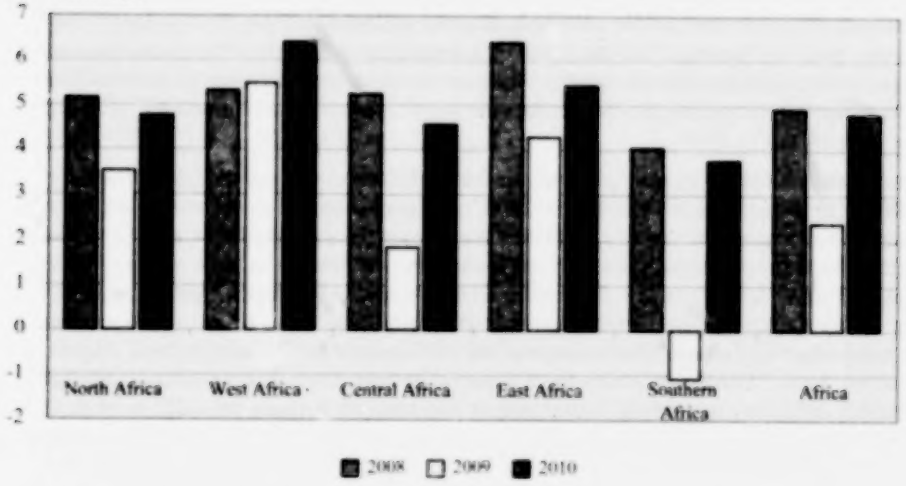
### Significant deceleration in growth in 2009

5. Overall, Africa's GDP growth slowed down markedly in 2009, although it showed some resilience compared with previous episodes of economic recession. Recent commodity price booms were better managed than previous episodes, with a number of countries accumulating significant external reserves and fiscal savings and recording lower debt. This prudent approach provided countries, particularly the oil-producing countries, with ample room for policy actions in the wake of the global economic downturn (United Nations, Economic Commission for Africa and African Union Commission, 2009; International Monetary Fund, 2009). The pace at which GDP grew differed across countries and subregions.

### Growth performance varied across and within subregions

6. On average, oil-exporting countries expanded more vigorously than the oil-importing countries, owing in large to the more initial favourable conditions on the basis of which they weathered the global recession, including large fiscal and current surpluses, strong external positions and low debt. A few oil-importing countries, including Djibouti, Ethiopia, Malawi, Morocco, Rwanda, Uganda and Zambia also showed considerable resilience, posting GDP growth of more than 5 per cent because of a variety of country-specific factors. West Africa expanded by 5.6 per cent in 2009, displacing East Africa as the fastest-growing subregion. West Africa was followed by East Africa (4.3 per cent), North Africa (3.6 per cent), Central Africa (1.8 per cent) and Southern Africa (-1.1 per cent) (figure II).

Figure II
**Subregional growth performance, 2008-2010**
(Percentage)




*Source*: Economic Commission for Africa calculations based on data from the Department of Economic and Social Affairs, April 2010.

7. Economic activity declined in Central Africa, with GDP growth falling from 5.2 per cent in 2008 to 1.8 per cent in 2009. Economic contraction was recorded in Gabon, where decreased oil production and prices resulted in reduced Government revenues, which in turn brought about a decrease in Government spending. Similar developments led to a steep growth deceleration in Angola, where GDP expanded by a mere 0.2 per cent in 2009 compared with the double-digit growth rates sustained in recent years. GDP contracted in Chad owing to the poor performance of the agricultural sector. Economic growth decelerated significantly in Equatorial Guinea, but remained positive, thanks to higher hydrocarbon output and increased capital spending. Lower oil production and prices as well as slow activity in the timber and industrial sectors held back GDP growth in Cameroon.

8. Economic growth picked up in other countries in the subregion. The Congo posted GDP growth of 7.4 per cent owing to increased oil production. The economy of the Central African Republic recovered moderately, owing to rising donor support and increased investment in the mining sector.

9. East Africa's GDP growth, although slowing down, remained relatively robust. Economic activity expanded by 4.3 per cent in 2009, down from 6.4 per cent in 2008. This performance looked even more remarkable when set against the background of a subregional drought, which dampened growth in agriculture and agro-industry. The Ethiopian economy grew by 8.5 per cent, driven in part by the robust performance of non-agricultural activity, particularly services, and robust Government spending. Investment in infrastructure development in Djibouti and buoyant activity in the industrial and services sectors in Rwanda and Uganda helped maintain GDP growth of 5 per cent or more in these countries.

10. In contrast, reduced mining export receipts and their attendant spillover effects limited output growth in the Democratic Republic of the Congo to 2.7 per cent in

2009, down from the 6.2 per cent recorded in 2008. Lower agricultural output constrained Eritrea's GDP growth, which stood at 2.5 per cent in 2009. GDP contracted in Madagascar owing to political instability and civil unrest, and more severely in Seychelles, where economic activity declined by 7 per cent in part owing to the poor performance of the services sector. The prospects of the economy of Kenya rebounding in the aftermath of the post-election violence were constrained by the effects of the global slowdown. Kenya's GDP recovered only haltingly, growing by 2.5 per cent in 2009.

11. North Africa was also affected by the global recession, although moderately, with GDP growing at 3.6 per cent in 2009, compared with 5.2 per cent in 2008. This subregional aggregate largely reflected the remarkable resilience of the Egyptian and Moroccan economies, which expanded by 4.7 per cent and 5.2 per cent respectively, owing to bold fiscal and monetary stimulus packages. Other economies in the subregion recorded GDP growth of 3 per cent or less owing to various country-specific factors. The economies of the Libyan Arab Jamahiriya and Algeria slowed down sharply in 2009, by 2.5 per cent and 2.1 per cent respectively. A marked reduction in manufacturing output and tourism activity set GDP growth at 3 per cent in Tunisia, while a decline in iron ore production constrained economic activity in Mauritania, which rose by 1 per cent. The Sudanese economy expanded by 3.5 per cent in 2009, down from 7.6 per cent in 2008, owing to the decline in flows of foreign direct investment and weak activity in the construction sector.

12. Although GDP growth uniformly trended downwards in 2009 across the subregion, certain manifestations of dynamism can be discerned in some North African countries, particularly in the oil-exporting ones. For example, the non-hydrocarbon sector has grown vigorously in recent years, helped partially by rising public investment rates.

13. The impact of the economic and financial crisis on the real sector was more severe in Southern Africa than in any other subregion. The GDP of Southern Africa declined by 1.1 per cent in 2009, largely because of the contraction of the South African economy (-1.8 per cent) and the subregional spillover effects resulting from this contraction. Given its close integration in global financial systems, South Africa was one of the first countries on the continent to be affected by the global financial crisis. Furthermore, as the world slid into recession, exports and private demand declined in South Africa. This slowdown in economic activity affected neighbouring countries that are heavily dependent on trade and financial flows with South Africa. Growth in Swaziland slowed to 0.4 per cent, owing in part to reduced exports to and financial inflows from South Africa. GDP contracted in Namibia because of reduced mining output. Economic contraction was even more severe in Botswana, where GDP dropped by 6 per cent, owing to lower production and prices of diamonds. Elsewhere in the region, the GDP growth of Mauritius declined from 5.7 per cent in 2008 to 3.1 per cent in 2009, as export revenue, tourism receipts and foreign direct investment flows slowed down.

14. In contrast, economic activity picked up in Zimbabwe after a prolonged period of severe decline. GDP growth moved into positive territory, posting 3.7 per cent in 2009, bolstered by improved economic policies and credit expansion in a context of rising capital inflows and post-hyperinflation remonetization.

15. West Africa posted the strongest economic growth among all subregions, with its GDP accelerating from 5.3 per cent in 2008 to 5.5 per cent in 2009. This

development largely mirrored the strong performance of Nigeria economy in the subregion, which expanded by 6.7 per cent, owi expansion of oil output during the second half of 2009 as well as th performance of the non-oil sector. Elsewhere in the subregion, econ was uniformly moderate. Ghana posted the strongest GDP growth (4 underpinned by buoyant international prices for gold and increased ag industrial output. This, however, was a deceleration from the remark cent witnessed in recent years.

16. Côte d'Ivoire and Togo started recovering, although moderately. A economic recovery took shape in Côte d'Ivoire in 2009, where GDP 3.7 per cent, bolstered by high agricultural, hydrocarbon, mining output. The economic revival was sustained by an improved political situation. Growth also trended upwards in Togo, from 1.1 per cent in 20 cent in 2009. At the other end of the spectrum, economic activity p Guinea in the context of increased political instability and decr earnings, with real GDP remaining at the same level as in 2008.

## III. Inflation trended downwards, except in a few count

17. Inflation rates receded in the majority of African countries owing of factors. These factors include weak economic activity, which im demand pressures, reductions in the international prices of food a agricultural harvests in some parts of the continent and the extension o subsidies on basic food products. The pace at which inflation rate varied, however.

18. Price increases moderated markedly in Zimbabwe to 0 per cent, d three- and four-digit level witnessed recently. Increased money demar by post-hyperinflation remonetization, more than offset potential inflat associated with credit expansion. In the majority of the countries of Financial Community (CFA) inflation rates just ran below the official t cent, partly because of the continued appreciation of the CFA franc, fixed parity with the euro. Similarly, South Africa's inflation rate fe weak economic activity and lower international prices for oil an remained above the 3-6 per cent target band.

19. In contrast, inflation rates rose slightly in 2009 compared wit levels in a few countries, including in Angola, Ghana, Sierra Leone, United Republic of Tanzania and Zambia owing to country-spec including excess liquidity, currency depreciation and/or shortages caus in importing consumer goods. The most significant price escalation w in the Democratic Republic of the Congo. On a more positive note, c which excludes food and energy prices, slowed down in a number including Algeria and Uganda. This partly attests to the growing c central banks in anchoring inflation expectations.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## IV. Monetary conditions were loosened to mitigate the negative effects of the crisis on economic activity

20. As economic activity softened and inflationary pressures moderated, the majority of central banks on the continent adopted accommodating stances. The two central banks of the 15 countries in the CFA Franc Zone cut key interest rates and reduced reserve requirements in order to boost domestic credit and mitigate the impact of the global downturn on the CFA Franc Zone's economic performance. Similarly, central banks in Egypt and South Africa reduced interest rates several times. The Southern African countries whose currencies are fully or partially pegged to the South African rand followed suit by also imparting a countercyclical tone to monetary policy.

21. After tightening monetary conditions during the first half of 2009, Nigeria also started to loosen its monetary policy. The bailing out of five distressed banks, which together accounted for a third of total bank assets, also contributed to reversing course. Similar developments were also observed in the United Republic of Tanzania, where the central bank supported some commercial banks facing balance-sheet problems. Other countries, particularly the Democratic Republic of the Congo and Ethiopia, were confronted with excess liquidity owing in large to limited coordination between the Treasury and the Central Bank.

## V. Fiscal balances worsened in the majority of African countries in 2009

22. On average, fiscal balances deteriorated in much of Africa. This development reflected the combination of increased or constant public spending and declining government revenue in many countries, against a backdrop of falling GDP growth, lower external assistance and tightening global credit conditions. The resilience of public spending reflected the multiplication of fiscal stimulus packages on the continent, which were mostly delivered through spending rather than through revenue-based measures.

23. South Africa adopted a series of measures to boost infrastructure investment and expand social safety net systems in an attempt to sustain domestic demand in the face of reduced economic activity and to increase the country's long-term growth and employment potential.

24. Similarly, discretionary fiscal impulses targeted at major public investment programmes were initiated in Algeria, Cape Verde, Egypt and Rwanda in order to address infrastructure bottlenecks that had constrained growth. Ethiopia also planned, under its 2009/10 budget, to lessen the tight limits on public spending that had been set the previous year. Additional fiscal stimulus packages were implemented through 2009 supplementary budgets in Burkina Faso and Tunisia. Elsewhere, rising security and humanitarian spending in the Democratic Republic of the Congo and public service wage increases in Ghana and Swaziland accounted for the resilience of spending in these countries.

25. While public spending was resilient, government revenue declined, driven by shortfalls in customs collection due to weakened imports and lower tax revenue caused by weak economic activity. This resulted in rising fiscal deficits.

26. Against the background of declining external financing, rising fiscal deficits were increasingly funded from domestic sources, either withdrawals of government deposits from central banks or borrowing from central banks. Countries that adopted balanced budgets, whereby spending is capped to match available domestic and external resources, had little fiscal space to respond to the slowdown.

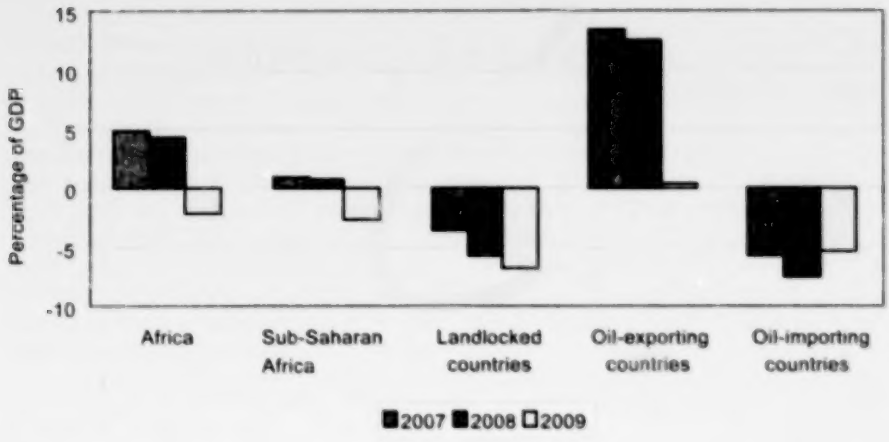
## VI. The real effective exchange rate appreciated in most countries

27. The majority of African countries recorded real effective exchange rate appreciation. This was largely the case in countries with fixed exchange rate regimes, including the CFA Franc Zone countries, the Libyan Arab Jamahiriya and Cape Verde, and those with relatively high inflation rates. Conversely, countries where the real effective exchange rate depreciated, for instance the Sudan, were mostly those where nominal exchange rates were allowed to depreciate in order to limit the effects of the global economic crisis on foreign-exchange reserves and/or to boost export competitiveness. These countries were predominantly countries that had floating regimes or managed float regimes.

## VII. Current-account balances deteriorated in the majority of countries

28. Africa's external balance switched from a surplus in 2008 (4.3 per cent of GDP) to a deficit in 2009 (-2.2 per cent of GDP), partly because export receipts plummeted more rapidly than imports. This aggregate figure conceals, however, variations among structurally determined groups of countries (figure III). Oil-exporting countries, as a group, ran a smaller surplus (0.3 per cent), while oil-importing countries recorded a deficit (-5.4 per cent). Also, landlocked African countries posted larger current account deficits (-6.8 per cent) than other countries, because of their much larger services account deficits, which reflect the high transport costs they face and their difficulties in competing in global markets for goods and services.

Figure III
**Current-account balance in Africa by category, 2007, 2008 and 2009**
(percentage of GDP)




*Source*: Economic Commission for Africa calculations based on data from the Economist Intelligence Unit, April 2010.
*Note*: Excluding the Democratic Republic of the Congo, Egypt, Guinea, Guinea-Bissau and Somalia.

29. Nowhere was the deterioration in current-account balances more visible than in oil-exporting countries. Lower oil prices translated into a significant decline in export earnings, which was not offset by the reduction in the import bill of these countries caused by lower oil and food prices and decreased demand for intermediate and capital goods. Current accounts therefore worsened, with surpluses declining in Gabon, the Libyan Arab Jamahiriya and Nigeria, or moving from surpluses to deficits in Algeria, Angola and Equatorial Guinea. Similarly, oil-importing and mineral-rich Botswana recorded a steep contraction in diamond and other mineral exports and weaker services exports, which resulted in the current account balance sliding from a surplus of 3.8 per cent of GDP in 2008 to a deficit of 5.6 per cent of GDP in 2009. In spite of the reduction in imports, driven by lower oil and food prices, current-account balances widened in a number of oil-importing countries with chronic current account deficits, including Cape Verde, Ethiopia, the Niger and Zimbabwe. This was caused by lower export earnings, remittances and tourism receipts. In contrast, current account deficits declined in a few countries owing to a varied set of factors, which included the resilience of remittances and tourism earnings in Tunisia, the severe contraction in imports in Kenya and South Africa and buoyant gold export earnings in Ghana, Mali and the United Republic of Tanzania.

30. With financial inflows decreasing sharply and nominal exchange rate depreciation mounting, rising current account deficits were financed through significant drawing on hefty foreign exchange reserves in some countries. External positions, however, remained strong in many countries, such as Egypt and Zambia,

owing in part to the recent allocation of special drawing rights from the International Monetary Fund (IMF).

31. The current environment presents countries with limited or declining foreign reserves with a difficult set of challenges. The tightening of external financing conditions might force them to shed imports of intermediate and capital goods as well as medicines, thus lowering long-term growth potential and compromising progress in social development.

## VIII. Recent trends in social development in Africa

32. Recognizing the fact that they are socially disadvantaged and most severely impacted by the economic crisis, this report reviews the social development status of the vulnerable groups, namely, older persons; orphans and vulnerable children; young people; people living with HIV and AIDS; refugees; the internally displaced; migrants; and the poor. Women in these groups suffer the most from shocks associated with economic and natural disasters and conflicts. In particular, the report reviews which factors have influenced the access of these vulnerable groups to food, education, employment and health.

### The size of vulnerable groups driven by natural population growth

33. The population of vulnerable groups has been increasing over time as a result of natural population growth (see table). The population of people living with HIV and AIDS has been increasing owing to social, economic and cultural factors that fuel HIV infection such as stigma, gender inequality, poverty, polygamy, wife inheritance, "dry sex", drug and alcohol abuse, mobility, sexually transmitted diseases, war and violence against women (Inungu and Karl, 2006). The increase in the number of people with disabilities is due to a number of reasons, chief among which are civil strife and continuing wars; a high level of illiteracy; undernutrition and malnutrition; communicable diseases; poor health services; a low level of social assistance and services; accidents and domestic violence; poor economic conditions in most of the countries; and old age and natural calamities and disasters (AUC, 2005).

**Population of vulnerable people in Africa, 2005 and 2008**

| | *Population (thousands)* | | *Percentage of total population* |
|---|---|---|---|
| *Category* | *2005* | *2008* | *2008* |
| Older persons[a] | 47 842 | 56 124 | 5.7 |
| Youth[a] | 189 157 | 201 562 | 20.4 |
| Persons with disabilities[b] | 90 590 | 98 700 | 10.0 |
| Persons living with HIV[c] | 20 400 | 22 000 | 2.2 |
| HIV/AIDS orphans[c] | 6 500 | 11 600 | 1.2 |
| Refugees[d] | 2 748 | 2 106 | 0.2 |
| Internally displaced persons[e] | 11 800[f] | 11 600[g] | 1.2 |
| Africa's total population[h] | 905 900 | 987 000 | 100.0 |

[a] Economic Commission for Africa African Centre for Statistics database, 2009.
[b] Based on the assumption that 10 per cent of the population live with disabilities.
[c] Joint United Nations Programme on HIV/AIDS (UNAIDS), 2009.
[d] Office of the United Nations High Commissioner for Refugees statistical database, 2009.
[e] Internal Displacement Monitoring Centre database.
[f] Estimate is for 21 countries.
[g] Estimate is for 19 countries.
[h] United Nations Population Fund, 2009.

34. The number of refugees in Africa (excluding North Africa) continued to decline for the eighth consecutive year, from a high of 3.4 million in 2000 (Office of the United Nations High Commissioner for Refugees, 2009). This was due to the successful repatriation operations to Angola, Burundi and South Sudan. However, according to the Office of the United Nations High Commissioner for Refugees (2009), renewed armed conflicts and human rights violations during 2008 also led to refugee outflows in Chad, the Democratic Republic of the Congo, Somalia and the Sudan.

35. Africa has the highest number of internally displaced persons (i.e. persons who are displaced within their own country) in the world, amounting to 11.6 million in 2008 in 19 countries (Internal Displacement Monitoring Centre, 2009). The three countries with the largest internal displacement situations are the Sudan (4.9 million), the Democratic Republic of the Congo (1.3 million) and Somalia (1.4 million). The major causes of internal displacement include armed conflicts, generalized violence, natural disasters such as floods and in some cases violations of international humanitarian law. Climate change is expected to lead to further internal displacement. The most recent findings of the Intergovernmental Panel on Climate Change indicate that the frequency and magnitude of climate-related disasters, such as flooding, hurricanes, desertification or even the "sinking" of stretches of land, are likely to increase as a consequence of global warming, and thus will further displace an ever-increasing number of people (United Nations, 2009a).

36. The other group that is vulnerable to income shocks is made up of those who live in extreme poverty. According to recent estimates, the proportion of the population living in extreme poverty in Central, East, Southern and West Africa, using the new US$ 1.25 per day international poverty line, was 51 per cent in 2005,

and it was 3 per cent in North Africa (United Nations, 2009b). This amounts to more than 400 million people. This group of poor persons also includes most of the people in the vulnerable groups indicated in table.

37. Women account for the majority of members of vulnerable groups. Women make up 55 per cent of older persons, 50 per cent of refugees, 51 per cent of internally displaced persons, 50 per cent of African young people and 60 per cent of people living with HIV and AIDS, and account for the majority of the poor (various sources including the Economic Commission for Africa statistical database 2009; UNHCR, 2009; Joint United Nations Programme on HIV/AIDS, 2009). Women and girls bear the brunt of the negative impact of the economic and food crisis, and they are falling deeper into poverty. It is important therefore that African countries embrace inclusive and particularly gender-sensitive development policies and programmes to improve the social development of vulnerable groups.

## Access of vulnerable groups to food constrained by endogenous and exogenous factors

38. Vulnerable groups face serious difficulties in accessing food and ensuring food security. Owing to the lack of explicit income transfers, food subsidies and price controls in many countries, the burden is being relegated to the population. Vulnerable groups such as older persons, persons with disabilities, refugees and the poor are most vulnerable to higher food prices owing to their lower incomes. Internally displaced persons are very vulnerable to food insecurity because in situations of conflict, lack of security impedes access by humanitarian agencies seeking to provide food assistance and other services (see box).

**Examples of food insecurity among internally displaced persons**

In the Darfur region of the Sudan, the United Nations estimated in May 2007 that 566,000 of the 4.1 million conflict-affected people were beyond the reach of humanitarian assistance. Consequently, malnutrition among internally displaced persons passed emergency levels of global acute malnutrition and in 2007, child malnutrition rates reached emergency levels for the first time in three years. Access for humanitarian organizations worsened during 2007, when up to 1 million internally displaced persons were out of reach of urgently needed assistance.

In Somalia, humanitarian access is severely limited by insecurity, which makes it difficult to provide food aid and other life-saving assistance to internally displaced persons. Camps for internally displaced persons lack basic facilities such as schools, health care and water and sanitation, leading to widespread acute malnutrition and diarrhoea. A survey carried out in November 2007 among the internally displaced populations in Afgoye and Merca in Somalia showed critical levels of malnutrition, in a region where 15 per cent of children under the age of 5 already faced a high risk of starvation.

In Côte d'Ivoire, malnutrition rates remained high, especially in landlocked areas and places where roadblocks and checkpoints prevented free movement.

*Source*: See Internal Displacement Monitoring Centre (2008) and Internal Displacement Monitoring Centre (2009).

39. HIV/AIDS in sub-Saharan Africa has left old people to shoulder the responsibility of looking after their own sick children and raising their grandchildren when their children die. Households headed by older persons and fostering orphans have been identified as being highly vulnerable to food insecurity (Muga and Onyango-Ouma, 2009; Makiwane and Kwizera, 2007; Adato and Bassett, 2008). These households face difficulties in producing food because of limited labour and other inputs and therefore experience higher rates of malnutrition.

40. Finally, droughts and the increased frequency of natural disasters owing to climate change are contributing to increased food insecurity for millions of Africans. The adverse effects of droughts and other natural calamities are particularly severe for vulnerable groups such as the elderly and the disabled, who in addition to physical assets often lack the necessary human capital and/or ability to cope with such conditions.

## Access to education biased against vulnerable groups

41. While Africa is making progress towards achieving universal primary enrolment, there are still about 46 million primary-school-age children who are out of school in East, Southern, Central and West Africa (United Nations Children's Fund, 2010). Also, the significant progress towards enrolment has not been accompanied by commensurate gains in completion rates. Particular groups of children who are more likely to be out of school or not to complete the full cycle of primary education include: street children, children with disabilities, child labourers, children living in conflict situations such as internally displaced children, children from poor households, children living in rural, remote and marginalized areas, and children orphaned by or infected with HIV and AIDS (United Nations Educational, Scientific and Cultural Organization, Institute for Statistics, 2005). More girls are out of school than boys, and the out-of-school girls are far more likely than boys never to go to school (United Nations Educational, Scientific and Cultural Organization, 2010). The two biggest factors of exclusion are crisis and conflict situations and a lack of response to the needs of children with disabilities (ibid.). More than half of the children without access to primary education live in countries affected by conflict, and a third are children with disabilities. Children with disabilities are by far the single group most likely not to be in school. Another important factor of exclusion is that only a few African countries have established free primary education, including tuition, uniforms and textbooks. This seriously affects resource-constrained households. In addition, one of the distinguishing characteristics of primary schooling in Africa is that secondary-school-age children attend primary school. This feature is particularly alarming for marginalized

children, as it exacerbates peer and household pressure for non-completion and entry into the labour market prior to completion.

42. The number of children and young people who are out of secondary education is alarmingly high in Africa. Yet, primary and secondary education is the starting point for developing a basic level of human capital. The lower level of education thus attained perpetuates the cycle of poverty across generations and reduces prospects of decent work opportunities.

43. In order to be competitive and have a chance of finding a decent job, African young people need to acquire knowledge and skills through higher levels of education and technical and vocational training. However, overall participation in tertiary education is very low on the continent. Only 6 per cent of the tertiary education age group was enrolled in tertiary institutions in 2007 in Africa, compared with the global average of 26 per cent (United Nations Educational, Scientific and Cultural Organization, Institute for Statistics, 2009). Very few young people from vulnerable groups are able to access higher education, mainly owing to a lack of resources to meet school fees.

44. It is important that public policies designed to improve access to all levels of education by the poorest and other vulnerable groups are made a priority. Overall approaches to use in "targeting" out-of-school populations should be tailored to specific marginalized groups, reduce obstacles preventing children from going to school and use inclusive multisectoral measures. Some of the many policies that have proved effective in some countries include abolishing school fees; building schools in underserved areas; introducing school feeding and nutrition programmes; supporting participation of girls and encouraging them to complete their education; affirmative action; and inclusive education and boosting recruitment of teachers (United Nations Educational, Scientific and Cultural Organization, 2010). This is essential to ensure that the right of everyone to education is recognized.

## Access of vulnerable groups to employment opportunities is limited

45. Women, young people, persons with disabilities, older persons, people living with HIV/AIDS, migrants and other vulnerable groups face particular challenges in obtaining decent work. Most end up in what the International Labour Organization (ILO) terms vulnerable employment (as unpaid contributing family workers or own-account workers or in seasonal employment or in informal and poorly paid petty business), which is characterized by insecure employment, low earnings and low productivity. Young people are faced with the challenge of high unemployment owing mainly to lack of experience and relevant training. Persons with disabilities lack access to decent jobs owing to discrimination, lack of relevant training and lack of physical access to buildings. People living with HIV/AIDS experience considerable barriers in finding and keeping a job, even before the disease renders them incapacitated because of stigma and discrimination.

46. Other important dimensions of economic participation by vulnerable groups include access to productive resources such as credit, technologies, information, land and other assets to enable them to undertake small-scale income-generating projects. However, people in the vulnerable groups lack access to these resources, and this affects their ability to move out of poverty.

47. Clearly, even before the onset of the economic crisis, vulnerable groups had limited access to employment opportunities and productive resources. Since most of them work in vulnerable employment that is less well-covered by social safety nets, they are more vulnerable to the impact of the crisis. Older workers who are displaced from the labour market are also likely to be affected because they have fewer chances of securing a job after losing one (United Nations, Economic and Social Council, 2009). Governments are likely to reduce public expenditure on programmes that improve the employment opportunities of vulnerable groups such as people with disabilities or young people. Migrant workers are hardest hit during economic downturns as the sectors in which they are employed, such as construction, manufacturing and hospitality services, are highly vulnerable to job cuts. It is important that Governments adopt or strengthen specific measures to promote employment opportunities for people in vulnerable groups.

## Problems in access to health care by vulnerable groups

48. Vulnerable groups have poor access to health care for social, economic and cultural reasons. In many countries, the physical infrastructure in the health field is limited in rural and remote areas. In conflict situations, destruction of the physical infrastructure, including roads and health and education facilities, increased personal insecurity and reduced personnel and supplies for social services exacerbate the risk that vulnerable groups such as displaced people and refugees may not be able to access health services. Older persons need more health assistance for non-communicable diseases, typically chronic, degenerative and mental illnesses, and disability-related problems. This situation demands specialist services and personnel that are not easily available to the growing numbers of older people.

49. The findings of an Economic Commission for Africa (ECA) study that investigated the extent of inequities in access to health care in a group of African countries — Chad, Cameroon, Egypt, Ethiopia, Ghana, Kenya, Malawi, Morocco, Senegal and Zambia — through analysis of demographic and health surveys show significant inequities in access to health care stemming from income differences, distance to a health-care provider, and rural/urban locations in all countries studied (United Nations, Economic Commission for Africa, 2008). Inequities are most extreme for delivery assistance, a key service that can reduce maternal mortality in line with Millennium Development Goal 5. For example, in Egypt in 2005, the absolute difference between the richest 20 per cent of the population and the poorest 20 per cent was approximately 43 per cent. In Ghana, in 2003, the absolute difference between the two groups was 70.5 per cent (United Nations, Economic Commission for Africa, 2008). The inequities exhibited in access to health care are replicated in the provision of water and sanitation.

50. Overall, both the elderly and persons with disabilities require health services that cater to their specific needs, reflecting the illnesses and ailments that occur in older age or affect those with a disability. For instance, people in a wheelchair require accessible facilities, which are absent in most African countries. Rehabilitation is also an important health service for both socially vulnerable groups. Hence the need for policies that ensure special access to health services for all vulnerable groups, including free or subsidized medical services.

# IX. Economic rebound in 2010, but subject to downside risks

51. Africa's GDP growth is projected to recover in 2010 and grow at 4.8 per cent. However, owing to considerable risks, Africa's growth in 2010 could vary between 4.2 per cent and 5.4 per cent.[1] Even under the most optimistic scenario, the pace of the recovery remains well below the level required to achieve a meaningful improvement in social conditions in Africa.

52. The expected pickup in economic growth will be supported by both domestic and international factors. The expected recovery of the global economy is set to increase demand for and prices of African export goods, in particular minerals and hydrocarbons, and services. Private flows, in particular foreign direct investment and portfolio investment, will pick up as well. On the domestic front, various fiscal and monetary packages adopted by many Governments on the continent are expected to continue to support domestic demand, which will also benefit from relatively low interest rates.

53. West Africa is expected to continue to be the fastest growing subregion (6.4 per cent) for the second consecutive year, followed by East Africa (5.4 per cent), North Africa (4.8 per cent), Central Africa (4.6 per cent) and Southern Africa (3.8 per cent). However, the strongest recovery will be recorded in Southern Africa. South Africa will lead the growth momentum, owing to rising mining output combined with renewed dynamism in services, in particular tourism, supported by the World Cup football tournament.

54. Average inflation in Africa is projected to decline further in 2010, owing in large part to a significant deceleration in price increases in countries that posted double-digit inflation rates in 2009. Despite expected rising food and oil prices, inflation rates will moderate in the Democratic Republic of the Congo, Kenya, Rwanda, Sao Tome and Principe, Seychelles, Uganda and the United Republic of Tanzania, driven by the expected gradual tightening of monetary policy and/or limited exchange rate depreciation. In contrast, demand-pull inflationary pressures will lead to strong increases in prices for non-traded goods, fuelling inflation in Angola, the Republic of the Congo, Equatorial Guinea and Gabon, whereas continued currency depreciation and/or the growing monetization of fiscal deficits will feed or sustain already high inflation rates in Guinea and Mauritania.

55. The outlook is, however, subject to downside risks, which are linked to structural weaknesses in African economies, in particular their excessive dependence on exports of primary commodities and low-value-added products. A slower-than-expected recovery of the global economy, a relapse into recession and/or the eruption of another global financial crisis would depress demand for and prices of African exports, decrease tourism receipts, weaken domestic financial markets, squeeze domestic credit and investment, and reduce private and official flows to the continent. Also, a severe deterioration in weather conditions would restrict agricultural output, thus lowering economic growth in many countries.

[1] GDP interval forecast is a series of values in which we expect the GDP to fall, with some probability. A 95 per cent confidence interval is calculated using the following formula: $g_p \pm 1{,}96 \cdot \hat{\sigma}$, where $g_p$ is the predicted growth rate and $\hat{\sigma}$ the corrected standard deviation. The corrected standard deviation is calculated on the basis of Department of Economic and Social Affairs forecast errors. A bootstrap method was used in order to correct potential small-sample bias.

Finally, any unexpected worsening in political and security situations might dampen growth prospects in some countries, particularly in those that are holding elections in 2010.

# X. Conclusion and recommendations

56. The recent global recession did not spare Africa. GDP growth for Africa as a whole fell markedly, with negative implications for employment and more broadly for social conditions across the continent. The continent, however, seems to have withstood the shock better than on previous occasions, mainly as a result of stronger initial positions. Countries that did well were mostly those that had had more broad-based sustained growth, i.e. countries that had been relatively successful in diversifying their production and export bases. Success in securing high and sustainable growth, generating enough decent jobs for the rising working population and achieving broader social development depends largely on success in economic diversification (United Nations, Economic Commission for Africa and African Union Commission, 2007). Macroeconomic and structural policies as well as institutional reforms formulated and implemented in Africa should be secondary to this broader developmental goal.

57. The downward inflation trends attest to the growing credibility of monetary policies in much of the continent. Yet, this achievement has not had discernible responses in the form of rising investment and economic growth rates, greater economic transformation and robust employment creation in African countries. This shortcoming can be addressed by ensuring that monetary policies pay adequate attention to developments in the real sector, including economic activity and employment, and not only to price stability.

58. Although fiscal policies turned out to be largely counter-cyclical, their effectiveness needs to be improved. The introduction of social protection schemes, particularly well-targeted social safety net measures, would be one way of achieving this. These fiscal measures, however, have some cost implications. Long-term fiscal sustainability requires that spending efforts go hand in hand with commensurate domestic resource mobilization and renewed efforts by the international community to live up to its aid commitments, particularly in favour of countries with limited fiscal space and with limited and dwindling foreign exchange reserves.

59. Success in diversifying the production and export base away from primary commodities requires competitive real exchange rates. Countries, irrespective of their exchange-rate regime, are confronted with the challenge of maintaining an appropriate real exchange rate that ensures the competitiveness of tradable goods and services. Raising spending in infrastructure, human capital and other productivity-enhancing activities will be an effective way of increasing economy-wide productivity and competitiveness.

60. Getting macroeconomic policies right will be insufficient if not complemented by structural and institutional efforts, including strengthening capacity in budget execution and reporting as well as reforms aimed at improving the business environment. Also, the consensus that emerged from the recent global financial turmoil is that there is a need to step up supervisory efforts in monitoring liquidity and credit risks. This is particularly important given the rapid expansion in private sector credit in some countries.

61. More broadly, in order to achieve the Millennium Development Goals and other social development goals, African countries should put social development, particularly that of the vulnerable groups, at the forefront of their development agenda. The global economic crisis has heightened the need to develop and strengthen measures that ensure the inclusion of vulnerable groups in the mainstream development framework. Addressing the impact of shocks to the vulnerable groups is essential for realizing the basic human right of access for all to food, health, education and employment. This will promote social development and contribute to the acceleration of progress towards achieving the Millennium Development Goals.

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## Summary of the Economic and Social Survey of Asia and the Pacific 2010

*Summary*

By early in 2010, following the first global economic contraction in modern history, the contours of a "V-shaped" rebound had become evident in Asian and Pacific economies, shaped in large part by unprecedented fiscal stimulus packages. The rebound remains fragile and uneven, however, with a number of downside risks. While 2009 was a year for crisis management, 2010 will pose even greater complexity for policymaking. Turning the rebound into a sustained recovery requires maintaining the momentum together with macroeconomic stability in the face of rising inflationary tendencies and the potential for asset bubbles.

The crisis has drawn attention to the underlying global and regional structural imbalances built up over decades. Redressing them and the concomitant development gaps, and sustaining recovery after the withdrawal of the fiscal stimuli, require fairer, more balanced and sustainable patterns of development. Asian and Pacific countries are not likely to be able to return to business as usual. Instead, they need to drive their own development and create new sources of economic growth from within the region. In the radically altered global panorama, the Asia-Pacific region has emerged as a central participant in international economic relations. To fulfil its potential, however, it needs to implement an ambitious set of policies.

This document summarizes the key findings of the Economic and Social Survey of Asia and the Pacific 2010 which explores that complex environment and — lest the V-shaped rebound induce complacency — outlines the elements of a coherent regional policy agenda.

* E/2010/100.

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# I. Introduction

1. In 2010, as the region rebounds from economic crisis, a much more complex policy environment is emerging. The radically altered global panorama has placed the Asia-Pacific region at the cusp of an historic moment as a central participant in international economic relations. The crisis also presents an opportunity for policymakers to reorient macroeconomic recovery towards more inclusive and sustainable development.

2. The present document summarizes the key findings and policy recommendations that emerge from the *Economic and Social Survey of Asia and the Pacific 2010*. The current edition of the annual ESCAP survey presents an assessment of the economic crisis and its emerging policy challenges, followed by analysis of the many underlying imbalances and the ways in which the region could increase aggregate demand and supply. *Survey 2010* urges expeditious action on a policy reform agenda, lest the "V-shaped rebound" induce complacency.

# II. Coping with external vulnerability in 2009

3. The developing economies of Asia and the Pacific emerged in 2009 as the world's fastest growing: their annual growth rate as a whole was 4.0 per cent, with China and India growing at 8.7 per cent and 7.2 per cent, respectively. Excluding those two rapidly growing economies, however, the other developing economies in the region were in negative territory in 2009, contracting by 0.6 per cent.

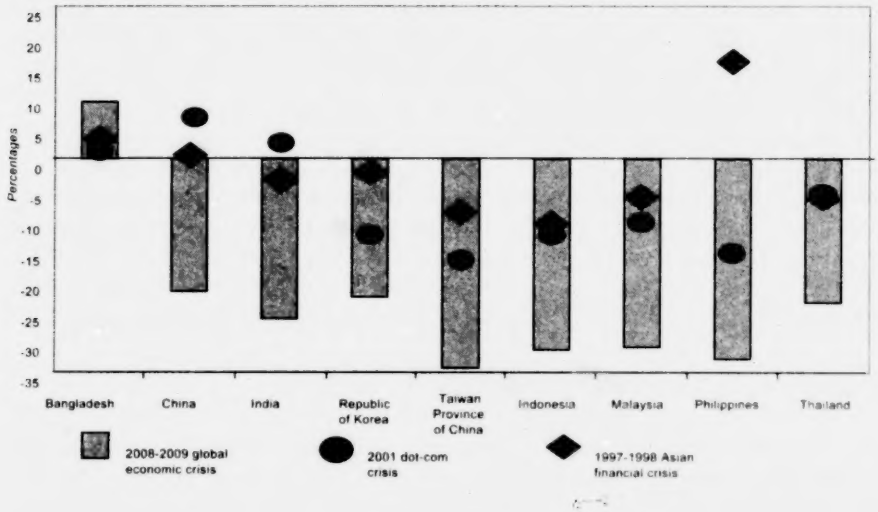
4. The regional impact of the global economic crisis varied across countries, a reflection of each country's vulnerability to external shocks according to its dependence on export-led growth and exposure to financial and exchange-rate instabilities. The degree of exposure depended on the demand structure in each economy, its fiscal space and the extent of its foreign-exchange reserves.

## A. Exposure to developed-country demand

5. The impact of the crisis was transmitted through trade shocks to the highly export-oriented economies in the Asia-Pacific region From August 2008 to June 2009, exports dropped sharply at annual rates almost twice as large as those experienced in the aftermath of the 1997 Asian financial crisis and the 2001 dot-com recession (figure I). Monthly contraction rates were even more dramatic, exceeding 30 per cent in many countries and even 40 per cent in certain instances in the Philippines, the Russian Federation and Singapore. As income growth in the region waned, imports dropped even more sharply, owing to the high import content of the region's exports.

Figure I

**Comparative growth performance of goods exports of major Asian developing economies during three crises, 1997 to 2009**




*Source*: ESCAP calculations based on data from CEIC Data Company Ltd., available from http://ceicdata.com/ (accessed 16 Feb. 2010).

*Note*: Growth rates of 2008 and 2009 were computed using data of the first half of 2009 and the first half of 2008; those of 2001 were computed on the basis of 2001 over 2000; and those of 1997 and 1998 were computed on the basis of 1998 over 1997.

6. Three factors exacerbated the region's vulnerability to the crisis:

(a) First, the greater the share of the trade sector in the economy of each country, the worse the impact. Developing economies in the region inevitably took a hard hit since their export sector comprises close to 38 per cent of GDP, or 250 per cent more than the corresponding share of the three developed economies in the region;

(b) Second, with the region's large share of trade in developed markets, the direction of trade came to reflect the exposure of an economy to the source of market perturbation. The fall in import demand of the United States, Europe and Japan had a direct bearing on Asian and Pacific exports because of the region's large share in the imports of those developed countries;

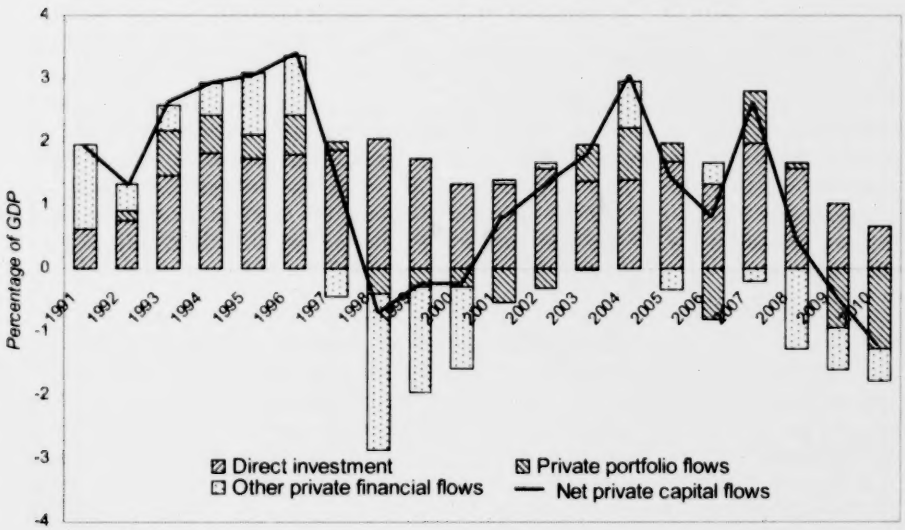
(c) Third, product mix was crucial. Trade in export items with a significant proportion of imported inputs fell first. The higher the share of products in a country's export profile that used imported electronic and automotive parts and components as intermediate goods, the more vulnerable that country was to the crisis.

## B. Exposure to capital flows

7. The region experienced the first impact of the crisis through short-term capital flows that triggered instability, not unlike in 1997. The manner in which capital flows operated in the current crisis was different than in 1997, however. At that time, the problem with capital flows lay more in excessive short-term foreign debt of domestic banks and other private-sector operators. Subsequently, during the past decade, another form of capital flow into the region was generated, that of foreign portfolio capital, which reversed direction when the crisis erupted in the United States and Europe. The patterns of net capital flows (figure II) show that the 1997 bust was due largely to reversal in short-term bank loans. In comparison, the crisis that began in 2008 was driven more by sharp reversals in portfolio flows, although inevitably many international banks retrenched on their lending in response to the financial stresses they faced.

8. The concern is exposure to risk of sudden outflows among countries that have experienced massive capital inflows during the previous year and thus have a stock of gross external liabilities that could potentially be reversible. Even countries with large current-account surpluses, such as Singapore and Malaysia, have experienced downward pressure on their reserves because of reversal of some gross external liabilities from previous years.

Figure II
**Net private capital flows to "emerging" Asia, 1991 to 2010**




*Source*: Based on data from IMF, *World Economic and Financial Surveys: World Economic Outlook Database*, Oct. 2009 ed.; available from www.imf.org/external/pubs/ft/weo/2009/02/weodata/index.aspx (accessed 25 Feb. 2010).

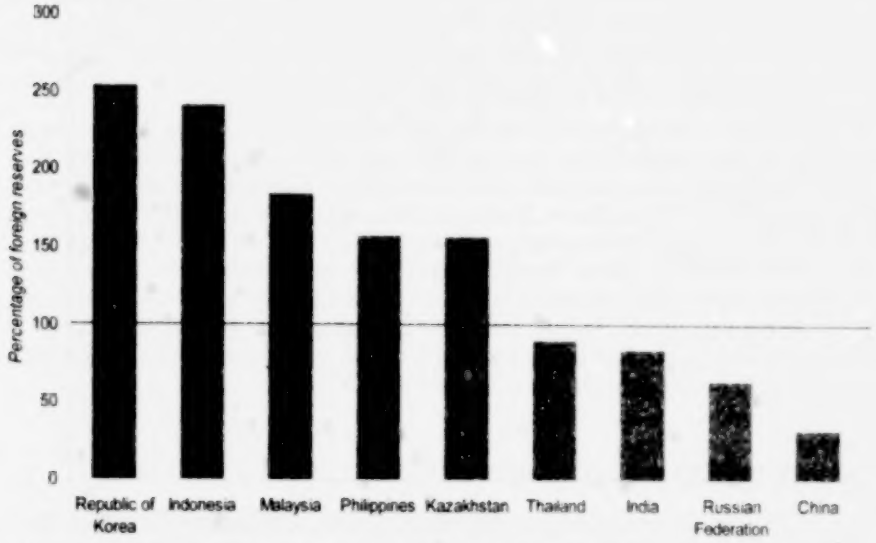
*Notes*: Data for 2009 and 2010 are projections by the International Monetary Fund. "Emerging" Asia comprises 26 Asian developing countries and newly industrialized economies.

9. The current financial crisis has underlined the importance of reserve holdings. The appropriate size of reserves remains a question; i.e. what defines an adequate or desirable amount of foreign exchange for any country to build up against possible need? As the current crisis has shown, holding reserves is neither cost- nor risk-free. Asia, as a whole, holds adequate reserves based on imports and short-term debt. To date, there is no yardstick to measure the potential vulnerability inherent in the reversibility of those other types of capital flows.

10. A more precise yardstick of vulnerability could encompass the overall gross external liabilities of a country that are most clearly reversible and measurable. The components would be short-term debt, the stock of portfolio inflows and the magnitude of imports over three months. The quantum of short-term debt and the stock of portfolio capital inflows are relevant because they could exit the country at any time and thus exert currency devaluation pressure. Similarly, the quantum of imports over three months represents the amount of reserves that would flow out as financing for imports. "Gross" would be more appropriate than "net" because, if foreigners chose to withdraw their funds, a country might not be able to coordinate its finances so as to be able to remit its gross external assets back to the originating country simultaneously (particularly if the investments to and from the country were executed by unconnected parties).

11. The threshold of foreign reserves is taken as 100 per cent. It is subject to a number of caveats, however. It may be an overestimate, if the portfolio market price in distress periods is much less than its historical value. Exchange-rate depreciations during a crisis may also reduce the stock of outflow. It may otherwise be an underestimate, in cases of countries that suffer exchange-rate pressure through capital flight by residents, or if short-term components of foreign direct investment such as private equity investment are not included. The likelihood of "internal drain" of such capital flight has increased in recent years because of liberalized regulation of financial outflows. Figure III displays the "vulnerability yardstick" of countries that were not fully covered by their foreign reserves at the end of 2008 after the worst of the financial impact of the crisis. In Indonesia, Kazakhstan, Malaysia, the Philippines and the Republic of Korea, the stock of foreign portfolio inflows accounted for the greatest part of the vulnerability yardstick, followed by short-term debt.

Figure III
**Vulnerability yardstick as a percentage of foreign reserves in major Asian developing economies, 2008**




*Sources*: ESCAP calculations based on data from IMF, *International Financial Statistics (IFS) Online Service*, available from www.imfstatistics.org/imf/ (accessed 24 Oct. 2009) and *World Economic and Financial Surveys: World Economic Outlook Database*, October 2009 ed., available from www.imf.org/external/pubs/ft/weo/2009/02/weodata/index.aspx (accessed 24 Oct. 2009); World Bank, *Quarterly External Debt Statistics* databases, available from http://web.worldbank.org/WBSITE/EXTERNAL/DATASTATISTICS/EXTDECQEDS/0,,menuPK:1805431~pagePK:64168427~piPK:64168435~theSitePK:1805415,00.html (accessed 13 October 2009); and CEIC Data Company Ltd., available from http://ceicdata.com (accessed 24 October 2009).

*Notes*: Vulnerability yardstick is the sum of short-term debt, imports of the last quarter of the year and stock of equity and debt portfolio capital. Data on stock of foreign portfolio investments of Indonesia, Malaysia and Philippines refer to figures for 2007.

12. How best to deal with portfolio capital flows? An uncontrolled inflow requires building up sufficient reserves to buffer sudden capital outflows — a costly undertaking. A completely open capital account might not be the right choice from a cost-benefit analysis; research suggests that the benefits of such openness are ambiguous, at best. Other options involve various types of controls, such as an international tax to moderate the volatility of portfolio inflows (the "Tobin Tax"), controls on inflows (Chile's *Encaje*, a one-year, non-interest-paying payment with the central bank), or quantitative controls on portfolio outflows — all are under discussion.

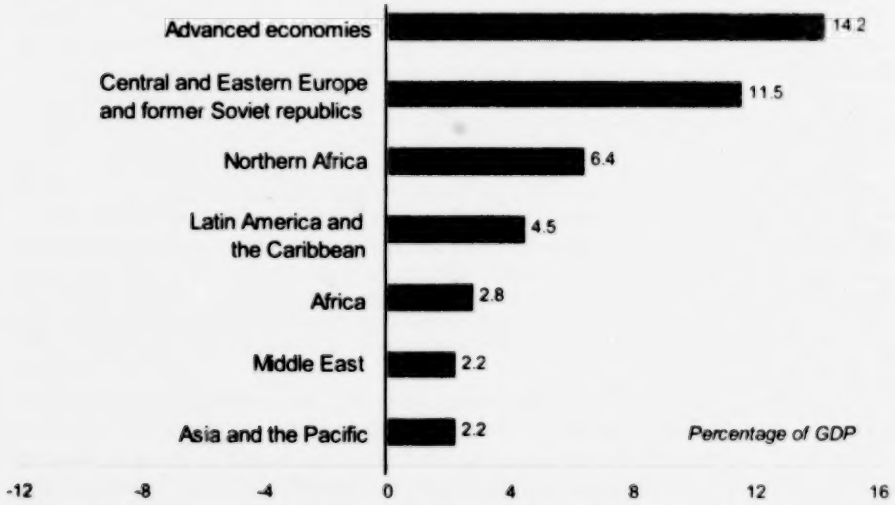
## C. Impacts on jobs and income

13. The collapse in aggregate demand from developed countries led to factory closures and massive job losses in many of the key export-manufacturing industries in the region, including textiles, garments, electronics and autos. The International

Labour Organization (ILO) has estimated that the number of unemployed in the Asia-Pacific region increased by 10 million between 2007 and 2009, bringing the unemployment rate up to 5.0 per cent. While the average unemployment rate of the region was below that of the average rate of 8.2 per cent of countries of the Organization for Economic Cooperation and Development (OECD) in the second quarter of 2009, certain features of unemployment in Asian developing economies are worrisome.

14. Increases in unemployment in developing countries exert far greater socio-political repercussions than in developed countries because social protection systems are lacking. As a region that has the lowest level of public expenditure on social protection (figure IV), millions who took decades to work their way out of poverty could slip back into poverty within months or even days, once their personal savings have dried up. From the estimates of ILO economic growth in the region, the current crisis could trap an additional 21 million people below the poverty line of $1.25-per-day or 25 million under the $2-a-day line. Inevitably, abuse and violence against women, children and youth rise in such conditions, with the brunt of social fallout lasting much longer than the crisis itself.

Figure IV
**Social expenditure as a percentage of GDP, for most recent year available**



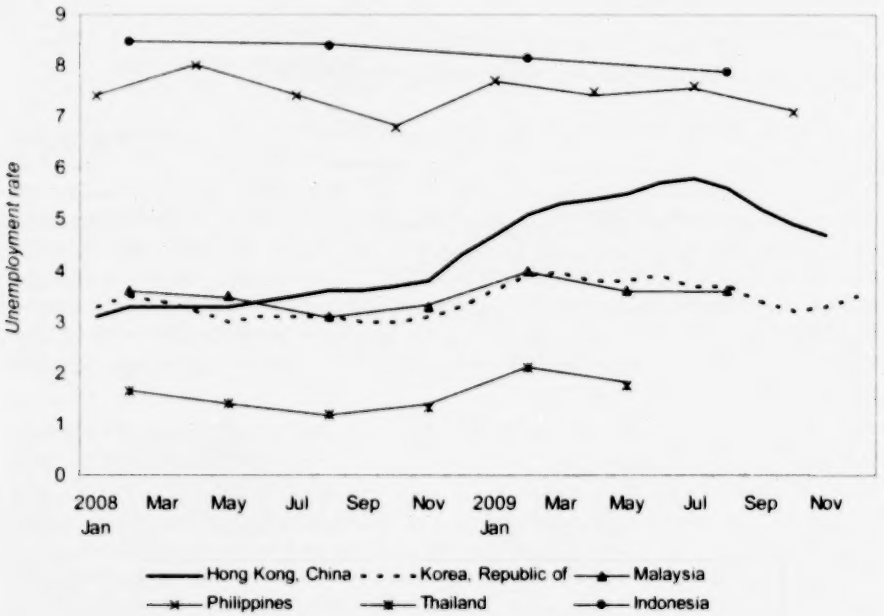

*Source*: ILO, *The Financial and Economic Crisis: a Decent Work Response* (Geneva, 2009).

15. For the region as a whole, "vulnerable employment" could have increased by as much as 47 million between 2007 and 2009, adding to the estimated 1.09 billion workers (60.7 per cent of all workers) who were classified as being in such employment in 2008. Unemployment figures in Asia and the Pacific are a crude measurement that grossly underestimates the fallout from the crisis. The lack of timely and reliable labour market information compounds the challenge of assessing the labour market impacts of the crisis. Furthermore, for many who have lost their job or whose income is reduced in the absence of social protection systems, shifting

to vulnerable and informal employment is often the only way they can support themselves and their family.

16. On a positive note, very recent labour-market data show signs of stabilization with unemployment rates having reached a peak in 2009 (figure V). Previous financial and economic crises have demonstrated a recovery lag in the labour market that can trail behind economic recovery by as long as 4 or 5 years. Furthermore, an additional 5 years may be needed in recovering lost ground in the struggle against poverty. Increases in informal employment are difficult to reverse. Real wages take time to recover, as does labour productivity. It is therefore imperative to (a) implement and sustain the appropriate mix of macroeconomic policies, (b) institute labour market reforms to enhance resilience and adaptability and (c) prioritize the allocation of resources towards building effective social protection systems.

Figure V
**Monthly and quarterly unemployment rates in six Asian economies, 2008 and 2009**




*Source*: ILO, *Laborsta* database, available from www.laborsta.ilo.org (accessed 18 Jan. 2010).

## D. Migration and remittances: bucking the pressures

17. During the last two decades, remittances have become an increasingly important source of external development finance, supporting balance of payments and contributing to the gross national product. Nevertheless, with some variations across Asia and the Pacific, remittances are proving to be by far the most resilient source of foreign exchange earnings of all capital flows to developing countries that

have otherwise fallen dramatically since the beginning of the economic crisis. The resilience of remittance flows to the Asia-Pacific region has been largely attributed to the comparatively stable stock of the migrant population in a wide array of destination countries, including neighbouring economies and the countries of the Cooperation Council for the Arab States of the Gulf (GCC) which fared better during the economic crisis than did the United States and developed countries in Europe. The critical question is what will happen to the stock and flows of migrant workers, given the growth in unemployment in the major destination countries? The latest data from some migrant-sending countries in the region have shown reduced flows of new migrant workers while a number of countries have introduced policies to restrict migrant workers' access to labour markets.

18. Recognizing the potentially devastating socio-economic consequences that large-scale return of migrant workers could have on development and poverty, Governments in some of the major migrant-sending countries have taken measures to counteract the negative impact on migrant workers. As patterns of migration from and within Asia and the Pacific continue to be affected by the growth slowdown in the coming months, such support programmes need to be sustained well into the economic recovery process.

## E. Fiscal stimulus packages: mitigating the losses

19. Asian and Pacific countries had varied capacities for responding to the financial crisis in 2009 which explains their contrasting experiences. The countries best able to mount rapid and large countercyclical spending programmes were those that entered the crisis with strong macroeconomic fundamentals; in particular, stable inflationary trends, sound fiscal balances and low ratios of public debt to gross domestic product (GDP). The massive additional fiscal spending helped reduce the impact of lower exports and the falling demand for services such as tourism, as well as reduced growth of migrant remittances. Even more importantly, the stimulus also afforded some protection to the vulnerable workers who had lost their jobs, typically the unskilled and very often women.

20. Quantitative analysis reported in the *Economic and Social Survey 2010* affirms that the stimulus packages have certainly had an impact and have offset to some extent the loss of exports. For each $1.00 lost in exports from the key economies in the region, the loss in GDP has been an average of $0.88; the losses have ranged from $1.10 in Japan, to $0.70 in China and to $0.40 in Malaysia and Singapore. If the only variable affecting GDP had been the fall in exports, GDP growth in 2009 would have dropped by 7.8 per cent. However, the actual shortfall in 2009 was only 4.2 per cent, thanks largely to the fiscal stimulus packages.

# III. Recovery on the horizon and challenges in 2010

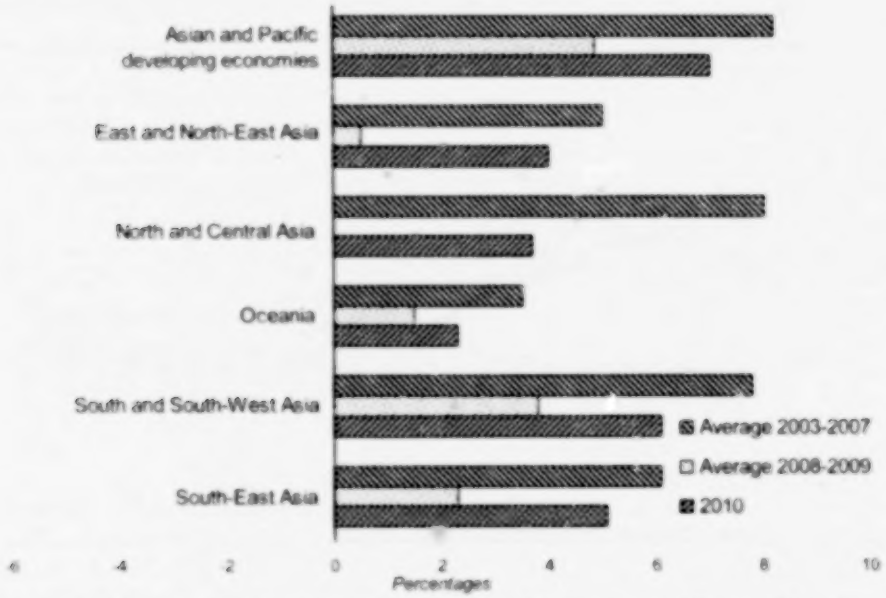
21. The outlook for 2010 has improved significantly, with developing Asian and Pacific economies forecast to grow by 7.0 per cent in 2010 (figure VI), led by the self-sustaining motors of China and India that are forecast to grow at 9.5 per cent and 8.3 per cent, respectively. The pace of recovery will vary across the subregion in 2010. South and South-West Asia will lead with growth of 6.1 per cent, after having performed at 2.9 per cent in 2009. North and Central Asia will experience

the largest rebound. The sharp downturn of the Russian Federation in 2009 saw growth in the subregion decelerate to -5.8 per cent; positive growth is expected to return in 2010, at 3.7 per cent.

22. Over and above the immediate risks in the recovery process, the nature of the recovery process holds issues of fundamental concern, particularly whether it will resurrect old challenges or create new obstacles for years to come. A complex set of policy challenges lies ahead.

Figure VI

**Average growth rates and forecasts of Asian and Pacific economies by subregion, 2003 to 2010**




*Sources*: ESCAP calculations based on national sources; IMF, *International Financial Statistics (IFS) Online Service*, available from www.imfstatistics.org/imf (accessed 26 February 2010); ADB, *Key Indicators for Asia and the Pacific 2009*, available from www.adb.org/Documents/Books/Key_Indicators/2009/default.asp (accessed 1 Oct. 2009); CEIC Data Company Ltd., available from http://ceicdata.com/; and website of the Interstate Statistical Committee of the Commonwealth of Independent States, www.cisstat.com (accessed 22 March 2010); and ESCAP estimates.

*Notes*: Rates of real GDP growth for 2009 are estimates and those for 2010 are forecasts (as at 15 Apr. 2010). Developing economies of the ESCAP region comprise 37 economies (excluding the Central Asian countries). Calculations are based on the weighted average of GDP figures in United States dollars in 2007 (at 2000 prices). Among the subregional groupings, Japan is included in East and North-East Asia, and Australia and New Zealand are included in Oceania.

## A. Inflation threatens from demand and supply sides

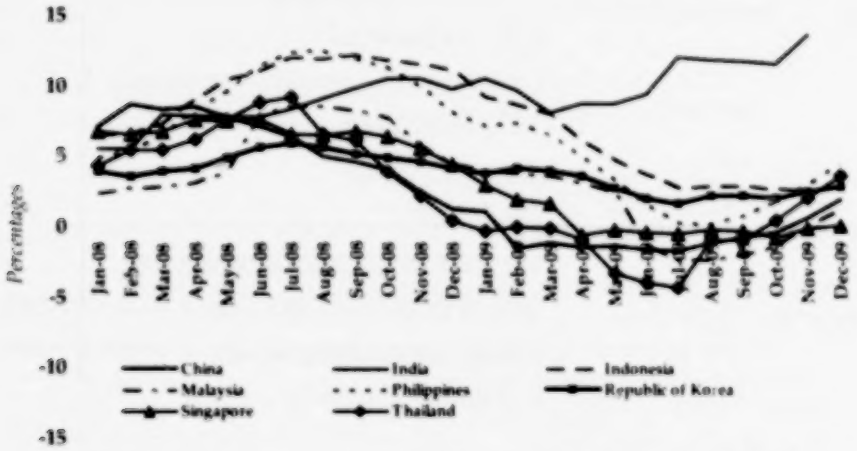
23. A key threat to the sustainability of regional growth is the return of inflationary pressures as the recovery gathers steam. Countries must balance the risk

of setting off an inflationary spiral with long-term negative growth against the risk of halting the short-term growth recovery trend. To date, increases in policy interest rates have been announced by Australia, Malaysia and India, among others. A critical decision for each economy is when and how to turn off the tap of fiscal stimulus and tighten monetary policy.

24. Inflationary pressure declined significantly after the last quarter of 2008, in tandem with the downturn in domestic economic activity (figure VII). The let-up proved to be short-lived as economic recovery led domestic demand to pick up, assuaging earlier fears of an unhealthy deflationary spiral. By July 2009, the fall in inflation rates since the start of the crisis had nearly stabilized in many countries, with inflation rates moving up in subsequent months.

Figure VII

**Consumer price inflation, year-on-year, in major Asian developing economies, 2008 and 2009**




*Source*: CEIC Data Company Ltd., available from http://ceicdata.com (accessed 20 Feb. 2010).

25. Other than increase in demand-side inflationary pressures, a key factor behind rising prices is the return of supply-side pressure from commodity price volatility. For that reason ESCAP urged policymakers in its *Survey 2009* edition to be vigilant in the post-crisis phase. Oil prices increased steadily during 2009. A return to high food prices could follow and requires close monitoring in coming months. Other factors potentially influencing a return to high food prices during 2010 could include weather-related events. Food price increases would seriously affect the poorest people of the region: impacting poverty, exacerbating inequality and worsening health conditions that would keep people trapped in their poverty.

26. Asset bubbles are another source of concern for the recovery process. Abundant foreign capital, provided via the fiscal stimulus packages and buoyed by liquidity support to financial institutions in developed countries, has been attracted to the region in recent months because of its relatively strong growth prospects. As the scale of inflows continues to rise, the risk also grows that any unexpected change in interest rates, or a sudden appreciation in value of the United States dollar, could trigger an exit of capital across target countries and financial asset

classes and precipitously bring down asset prices and exchange rates. T
how to manage the benefits from foreign portfolio investments and
attendant risks to macroeconomic stability remains a huge challenge for
Asset price bubbles could form in particular sectors with concomitan
domestic financial sectors and overall macroeconomic stability.

27. Liquidity has been injected into the United States financial sector t
Federal Reserve's purchases of mortgage-backed securities and other ag
Furthermore, foreign capital has been abundant with the rise in the d
trade, with borrowings at low dollar interest for investment in curren
region, where expectations of appreciation are strong and int
comparatively high. Asian and Pacific countries have been particularly
to the carry trade since earlier recovery than in other parts of the world
expectations of interest and exchange-rate expectations.

28. Domestic capital has also been attracted to regional asset markets
addition at the national level in a number of developing Asian countrie
monetary stimulus policies. Credit provision (figure 8) and asset prices i
of economies have increased substantially following declines during th
of the crisis, notably in China, India and the Russian Federation.

29. Riding on expectations of early and strong recovery, equity mar
region began an upward climb in the early part of 2009 (figure 9). In s
stock markets have returned close to levels seen immediately before
Furthermore, falls in the major markets before the beginning of their re
were far less severe, except for China, than those witnessed during the
Consequently, in global terms, Asian equity markets have seen one of
post-crisis recoveries of all developing country regions, reflectin
expectations of comparatively healthy growth prospects in international t

Figure VIII

**Credit growth, year-on-year, in major Asian developing economies, Jan
to October 2009**

*Source*: ESCAP calculations based on data from IMF, *International Financial Statis
*Online Service*, available from www.imfstatistics.org/imf/ (accessed 20 Jan. 20

*Note*: Data used in the chart refer to domestic credit comprising claims on central G
claims on the private sector and claims on other financial institutions.


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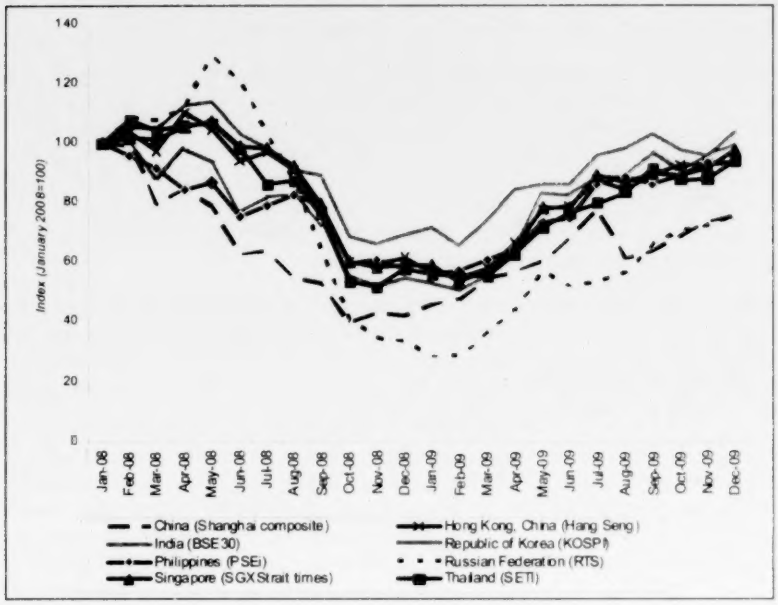
Figure IX
**Equity market performance in major Asian developing economies, January 2008 to December 2009**




*Source*: ESCAP calculations based on data from CEIC Data Company Ltd., available from http://ceicdata.com (accessed 20 Feb. 2010).
*Note*: The equity market of each country is noted in parentheses in the legend.

30. Asset markets are considered by many to be leading indicators of future economic performance. The recovery in prices appears to reflect the view of financial investors that growth will return to the region sooner rather than later. Whether investor optimism is exaggerated regarding recovery, or perhaps pushed by the need to invest buoyant funds available from the developed countries, is debatable. Consequently the risk of further volatility in financial markets looms in the months ahead.

31. Governments may consider moderating the inflows of short-term capital flows through various types of controls in order to maintain financial stability. Consensus is growing on the relevance of such measures as a part of the policy toolkit, especially in the context of huge expansion of liquidity in the world economy that is finding an outlet in the Asia-Pacific region.

## B. Avoiding premature exit policies to preserve growth

32. The recovery phase for economies in the region challenges policymakers with critical questions: when, in what sequence and at what pace to start to withdraw stimulus programmes that have been key support for growth after the crisis. Provided inflationary and fiscal pressures remain within reasonable norms, the general priority for policymakers is to continue with such programmes until self-perpetuating motors of growth appear to be firmly entrenched.

33. Budget deficits across the region are naturally of concern. Resolving the consequences of deficits are a medium-term challenge. Those deficits were exceptions from otherwise prudent fiscal policies. The relatively stable macroeconomic fundamentals in most countries means that increased levels of borrowing remain sustainable and can be paid off over time. Therefore while fiscal pressure is undoubtedly a challenge in the medium term, the key short-term concern for the region remains inflationary pressure.

34. On the balance of risks, and with variations across countries, the region's interest lies in sustaining growth rather than in allowing inflation to rise. For that reason, policymakers should guard against a premature exit from stimulus policies until growth demonstrates that it is self-sustaining. Furthermore, when exit policies are enacted, the mix of fiscal and monetary policies is important for the twin tasks of sustaining growth while managing inflation. Monetary tightening is a most effective policy in controlling price pressures because it acts directly on credit build-up.

35. Decisions on timing of exit from stimulus policies depend on national considerations; yet a key role remains for regional coordination, primarily to prevent negative macroeconomic repercussions. For example, early withdrawal of fiscal stimulus in the larger countries could impact severely on regional aggregate demand and export prospects for smaller economies. Likewise, monetary tightening through an increase in interest rates, in the absence of similar rises in other economies, could attract portfolio flows that would increase inflationary pressures as well as exert upward pressure on nominal exchange rates, thereby dampening recovery prospects for exports.

## C. New engines of growth for sustaining dynamism

36. Current projections show substantial declines in import demand in the United States over the next few years, as the debt-driven consumption pattern of the country remains constrained. Asian and Pacific countries are expected to be affected in varying degrees since they depend on exports to specific countries and exposure to the United States market.

37. Contrastingly, the period preceding the global financial crisis was one of exceptional export growth. Between 2001 and 2007, the exports of 11 Asian developing economies grew at an average annual rate of 12.8 per cent, more than doubling in value from $2.3 trillion to $4.8 trillion over that period. Recent forecasts of the export growth rate for those same countries from 2011 to 2014 predict an annual shortfall of between 3.1 per cent and 5.4 per cent from the 2001-to-2007 trend. In nominal terms the slowdown represents a drop in aggregate demand of $200 billion to $324 billion per annum, or between 1.4 per cent and 2.1 per cent of the GDP of those countries.

38. The foregoing portrait of performance is consistent with the observation of the Asian-Pacific Economic Cooperation (APEC) leaders at their 2009 summit in Singapore, that the advanced economies are unlikely to be able to return to "growth as usual" or "trade as usual". Even if the advanced countries achieve substantial economic recovery, their demand for imports from Asia and the Pacific is not expected to return to pre-crisis levels. In order to unwind global imbalances, many of the developed economies need to restrain debt-fuelled consumption. Asian and

Pacific countries, for their part, need to seek new sources of growth: to "rebalance" their economies in favour of increased domestic and regional consumption. For domestic and regional demand to increase its contribution beyond such temporary fillips, policy changes should induce a long-term structural rebalancing of economies. Such a strategy requires addressing critical global and regional imbalances.

# IV. Imbalances and development gaps: new engines of growth?

39. The ESCAP *Survey 2010* investigates the different imbalances and gaps — macroeconomic, social, developmental and ecological — and considers ways of closing them and augmenting aggregate demand that could serve as new regional impulses for growth.

## A. Macroeconomic imbalances

40. Global imbalances have in the past helped the Asia-Pacific region by expanding markets for exports and augmenting foreign exchange reserves. But those imbalances are not sustainable. They have resulted in growing trade and current account imbalances that the United States, in particular, with its high levels of accumulated debt, must unwind. Macroeconomic imbalances also exist within the region — notably between the economies of East and South-East Asia and those of South Asia. In East and South-East Asia net exports have increased as a proportion of GDP growth while in South Asia they have been increasingly negative. For East Asia that reflects a declining share of consumption in long-term economic growth, whereas for South-East Asia it reflects a declining share of fixed investment. In the South Asian case, on the other hand, the share of both consumption and investment has risen and is reflected in net import growth. Perhaps the most disturbing aspect of the global imbalances is the anomaly of investment capital flowing from developing Asia and the Pacific to developed countries in the West. That happens largely because Asia lacks a well-developed regional financial architecture wherein countries running current account surpluses could deploy them productively in other parts of the region.

## B. Socio-economic imbalances and development gaps

41. Asia and the Pacific also harbour large socio-economic and development gaps. Although the rapid economic growth of the region has helped lift millions out of poverty, over 950 million people live under the $1.25-per-day poverty line. Moreover, development has been very uneven across subregions and between countries. The patterns of progress towards achieving the Millennium Development Goals reflect the gaps: South-East Asia leads the way and South Asia and the Pacific island economies lag behind. Similar gaps exist in infrastructural development, evident from the composite scores presented in *Survey 2010*. The high-scoring economies include Australia, Brunei Darussalam, Japan, New Zealand, the Republic of Korea, Singapore, and Hong Kong and Macao, China. Others still have considerable infrastructural gaps, particularly the least developed, landlocked and small island economies, such as Papua New Guinea, Nepal, the Lao People's

Democratic Republic, Solomon Islands, Cambodia, Bhutan, Vanuatu and Mongolia. If the countries could invest in closing their socio-economic development gaps, they could also improve the quality of life for all as well as boost regional aggregate demand, opening the way for more inclusive and sustainable economic growth. That would demand high and sustained levels of investment that would involve creating a new regional financial architecture to mobilize the necessary resources from within the region and beyond.

### C. Ecological imbalances

42. The Asia-Pacific region also has serious ecological imbalances that are observable in the degradation of such natural resources as forests and freshwater, the unsustainable use of energy and rapid growth in carbon emissions, among other evidence. Although such degradation might not appear to have immediate economic consequences, it impedes achievement of sustained economic growth in the long term. Investment in addressing the imbalances could help countries to preserve their natural environment on which so many poor people depend, as well as maintain the basis for long-term growth. In the short term, countries would also be providing an immediate economic stimulus that would further help alleviate poverty.

43. In summary, as the countries of the region take steps to address macroeconomic, developmental and ecological imbalances, they have the opportunity to create new motors for inclusive growth that could help them regain their economic dynamism. The region has close to 1 billion people living in poverty who at the same time constitute a potential source of demand, if national development programmes succeed, for boosting private consumption and investment. Similarly, Asian and Pacific economies have the opportunity to develop new and greener industries and businesses based on innovations that could save energy and materials. In so doing they could provide more affordable products for the poor while maintaining growth and promoting environmental sustainability.

44. In the aftermath of the global economic crisis, *Survey 2010* argues that inclusive and sustainable growth is not only a desirable but also a necessary condition for regaining regional dynamism. The current edition outlines a policy agenda at national and regional levels that is designed to help in unleashing the latent potential of domestic and regional demand to address the three imbalances in an integrated manner.

## V. A policy agenda for inclusive and sustainable growth

45. The ESCAP *Survey 2010* explores ways of increasing aggregate demand and supply that could reconfirm for countries an inclusive and sustainable path of development and help them do their part in boosting regional connectivity. It proposes an agenda with four parts that could help in expanding domestic consumption and a fifth part for regional consumption.

## A. Strengthening social protection

46. If poor households could rely on systems of social protection that automatically trigger social safety nets in adverse times, they would be able to maintain food intake and continue to use education and health services. During normal times their need to keep precautionary savings would be reduced, so they could use more of their income for consumption. Systems of social protection thus serve as automatic stabilizers, supporting households at times of crisis and, equally importantly, expanding opportunities for individual and national development.

47. The Asia-Pacific region can showcase ambitious examples of social security programmes that could be replicated and extended elsewhere. Since 2001 the Government of Thailand has sponsored health-care services for all people nationwide who are not covered by other insurance programmes. In India, the National Rural Employment Guarantee Act (NREGA) guarantees 100 days of employment each year to adult members of rural households in a programme with gender-sensitive considerations. For the past several years, the Philippines has provided, through the Pantawid Pamilyang Pilipino Program ("4Ps"), conditional cash transfers to poor households for their health and educational needs.

## B. Fostering a second green revolution for agriculture and rural development

48. Since the 1970s agricultural growth has been largely based on "green revolution" advances that helped Asia and the Pacific to achieve significant yield increases — apart from the concomitant problems stemming from high inputs. As the region aims for economic growth with better "balance", it needs a second green revolution that would combine further advances in science and agricultural engineering with its own traditional knowledge and could endow agriculture with greater environmental resilience. Governments also need to make agriculture more socially inclusive by returning ownership of land and resources to farmers and by economically empowering the poor. To do so requires setting appropriate prices for key inputs and establishing institutions to help small producers achieve economies of scale in marketing and in accessing international markets. Governments may have tried earlier to use State or parastatal agencies for the task. The path of choice for the future appears to lead through community-based organizations and farmers' self-help groups. International partnerships and South-South cooperation could also help foster such a green revolution while also addressing concerns for food security.

## C. Supporting new engines of growth: green innovations

49. "Green Growth" policies emphasize environmentally sustainable consumption and production to foster low-carbon, socially inclusive development. Governments may take the industrial policy approach by collaborating with industry to promote investment in environmentally friendly technologies and products. Such investments might not be immediately profitable, so many environmentally friendly technologies might initially need governmental support. The public sector could also help develop and commercialize products that raise people's well-being generally by encouraging affordable and environmentally friendly innovations such as the solar

home-electricity systems popularized by Grameen Shakti in rural Bangladesh. A number of Asian and Pacific countries including Japan, China, India and the Republic of Korea are promoting such innovations as a part of national action planning on climate change. China, for example, has become the top investor in clean energy, with investments reaching $34.6 billion in 2009. The Republic of Korea plans to spend $84 billion over five years to develop environmentally friendly industries as engines of growth. Governments could also encourage adoption of environmentally sound practices and technologies through appropriate regulations and systems of incentives and taxes.

50. In developing countries the introduction of such innovations could be accelerated if the developed countries that already possess environmentally friendly technologies would relax some of their intellectual property rights provisions and help with acquiring financial backing, following the principles of common but differentiated responsibilities in the United Nations Framework Convention on Climate Change. Developing countries could also help each other in the area of sustainable consumption and production by sharing experiences and best practices. A number of them in Asia and the Pacific already have a range of technological capacities in such areas as biofuels production, waste management and solar and wind power. Waste Concern, a Bangladeshi non-governmental organization, has developed a system of decentralized treatment plants for managing solid waste; with ESCAP support it has encouraged similar approaches in Pakistan, Sri Lanka and Viet Nam.

## D. Enhancing financial inclusion

51. A well-functioning financial system is crucial to economic growth, but it would not be enough to ensure expansion in aggregate demand. If the poor are to realize their potential market capacity, they will need access to a more diverse and appropriate range of financial products and services. Savings, credit and insurance products tailored to their requirements, on better terms and with less stringent demands for collateral, would be essential and already have demonstrated success in application. Households that are able to take advantage of microfinance and microinsurance, for example, are in a stronger position to increase their incomes and boost quality of living for families as measured in levels of nutrition and standards of education. Moreover, women in such households tend to have greater autonomy in decision-making and are better able to improve the well-being of their families. To date, however, across most developing Asian and Pacific countries, financial services are used by only a small proportion of the population. The poor are typically excluded from the formal financial sector and from commercial bank services. Barriers exist on both the demand and supply sides. Governments therefore need to ensure an institutional and regulatory environment that fosters inclusive, fair and efficient banking systems, in order to expand and safeguard options for the poor.

## E. Evolving a regional framework for cooperative action

52. With some of the world's largest and fastest-growing economies, Asia and the Pacific could grow as an economic powerhouse if it could integrate its own regional market. Such an advance would require a new development paradigm that would be

more inclusive and sustainable. For historical, political and topographical reasons, the region has customarily been better connected with Europe and North America than it has been within itself.

53. *Survey 2010* has identified four priorities to enable leveraging of complementarities across the region and help in securing a more inclusive and sustainable path of development:

(a) *Regional economic integration*: The Asia-Pacific region harbours a complex network of political groupings, whose leaders in recent times have envisioned the evolution of a unified economic space. The time has come to move from vision to action. To do so they could accelerate progress on two current overlapping proposals: the East Asia Free Trade Agreement (EAFTA) which brings together the ASEAN+3 grouping; and the Comprehensive Economic Partnership of East Asia (CEPEA) of the East Asia Summit (EAS), whose members include those in the ASEAN+3 grouping plus Australia, India and New Zealand (or ASEAN+6). The proposals could serve as stepping stones to an even broader, unified Asia-Pacific market and an economic community;

(b) *Integrated trade and transport policies*: The region has improved its highway and railway networks but cannot use the infrastructure effectively without a legal and regulatory framework to enable vehicles, goods and people to move across borders and transit countries. International movement in many parts of the region is hindered by slow and costly processes, formalities and procedures. The region needs to develop an integrated, multimodal transport system. To do so, intermodal transfer points, also known as dry ports, are one element in a holistic solution where goods, containers or vehicles could be trans-shipped using the most efficient mode of transport along with facilities for product grading, packaging, inspections and the processing of trade documentation. The areas surrounding dry ports could thus emerge as growth poles, bringing new investment and employment opportunities to impoverished hinterlands while reducing the pressure on coastal areas. Building on its Asian Highway and Trans-Asian Railway networks, the ESCAP secretariat is helping the region develop a network of dry ports while improving trade and transport facilitation. ESCAP and regional organizations are collaborating with ASEAN in developing a connectivity master plan;

(c) *Information and communications technology (ICT) superhighways*: Expanding markets and business opportunities and creating a more unified economic space depends crucially on improved intraregional ICT connectivity for reducing the digital divide and accelerating cross-border information and communication flows. One of the main tasks would be to expand international bandwidth, particularly for landlocked and Pacific island developing countries. New connectivity could help in establishing systems for early warning and disaster response;

(d) *Regional financial architecture*: The global economic crisis has highlighted the lack of regional response options. Governments have had to create most of the measures. So far, the cooperation has been largely limited to the Chiang Mai Initiative, which has been made multilateral with a reserve pool of $120 billion for meeting the temporary liquidity needs of ASEAN+3 countries. The region needs to develop its financial architecture further to include systems of intermediation between its large savings and its unmet investment needs. One option would be to create an infrastructure development fund managed by a regional institution. If such

an institution could secure just 5 per cent of the region's reserves of nearly $5 trillion, it would have start-up capital of $250 billion and could borrow from the region's central banks. Pooling of reserves could help in meeting some of the regional investment needs for transport, energy, water and telecommunications, which are estimated at more than $800 billion per annum.

54. Another useful area for new financial architecture would be exchange-rate coordination. As trade among the economies of the region increases, a currency management system is needed for facilitating trade and macroeconomic stability. One option would be a basket parity relative to a number of reserve currencies instead of the United States dollar alone, and a common set of weights that is determined by regional trade share.

55. If Governments had access to a well-endowed regional crisis response and prevention facility, they would feel less in need of large foreign-exchange reserves to protect themselves against speculative attacks and liquidity crises, and could thus utilize their reserves for more productive investments. Enhanced regional cooperation should not, however, be regarded as an alternative to full participation in global economic relations. It should rather be seen as complementing participation — filling in the gaps and establishing the building blocks of global multilateral cooperation.

56. A new regional financial architecture would help in developing policy coordination and an Asian and Pacific perspective on various global proposals that are emerging from the G-20, the United Nations and other forums. Proposals under discussion include, for example, an SDR-based global reserve currency, a global tax on financial transactions to moderate short-term capital flows, and international regulations for the financial sector to curb excessive risk taking.

57. The Asia-Pacific region has an historic opportunity for regional cooperation. In recent months, some of the region's major economies have started a process of deepening mutual engagement. If they are to realize their more ambitious plans, they need to put forward more than general statements of intent.

58. Member States may rely on ESCAP, as the regional arm of the United Nations and the all-inclusive forum of the Asia-Pacific region, to provide the analysis and facilitate the policy consensus needed in order to move ahead on the collective journey.

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**Regional cooperation**

## Latin America and the Caribbean: economic situation and outlook, 2009-2010

*Summary*

After six years of uninterrupted growth, the gross domestic product (GDP) of the Latin American and Caribbean region fell by 1.9 per cent and per capita GDP by 3.0 per cent in 2009. The fall-off in growth hurt the labour market and the unemployment rate in the region is estimated to have risen to around 8.3 per cent.

The effects of the crisis were channelled mainly through the real sector of the Latin American and Caribbean economies. Exports, remittances and tourism activity all declined, and foreign direct investment (FDI) contracted. Commodity prices and terms of trade also suffered negative impacts.

Domestic activity levels also dropped in some countries as a result of the tighter credit conditions in the private banking sector. These factors combined with a downturn in economic expectations, which led to a fall in investment and private consumption.

The positive stimulus of fiscal policy action was one of the distinctive features of economic management in 2009, since many of the region's countries implemented countercyclical policies. These packages, together with the gradual return to normalcy in the financial markets, created the conditions for an upturn in activity and an improvement in labour-market indicators in the region starting in the second quarter of 2009. In addition, renewed access to international credit for some countries and the recovery of the stock markets allowed the private sector to restructure its assets and helped normalize lending.

In light of these developments, growth is projected at 4.1 per cent for 2010 and is expected to be somewhat higher in the countries of South America than in the rest of the region, given their larger domestic markets and greater export-market diversification. On the other hand, growth is expected to be slower in some of the more open economies that have a less diversified portfolio of trading partners and a heavier dependence on manufacturing. The same can be said of the Caribbean economies, some of which are facing complex financial and exchange-rate situations.

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# I. General trends and the financial crisis

1. The impact of the international crisis, the deepest in 60 years, was felt heavily in late 2008 and early 2009, albeit in different ways, in all the countries of the region. As a result, after six years of economic growth, the gross domestic product (GDP) of the Latin American and Caribbean region shrank by 1.9 per cent in 2009, which translates into a contraction of around 3.0 per cent in per capita GDP.

2. The heaviest contractions in economic activity occurred in Mexico and some of the Central American and Caribbean countries. South America registered positive growth rates although, in all cases, they fell far short of the rates posted between 2004 and 2008, and for 2009.

Table 1
**Latin America and the Caribbean: gross domestic product**
(Annual growth rates, 2005-2010)

| Country | 2005 | 2006 | 2007 | 2008 | 2009[a] | 2010[b] |
|---|---|---|---|---|---|---|
| Argentina | 9.2 | 8.5 | 8.7 | 6.8 | 0.9 | 4.0 |
| Bolivia (Plurinational State of) | 4.4 | 4.8 | 4.6 | 6.1 | 3.5 | 4.5 |
| Brazil | 3.2 | 4.0 | 5.7 | 5.1 | -0.2 | 5.5 |
| Chile | 5.6 | 4.6 | 4.7 | 3.2 | -1.5 | 4.5 |
| Colombia | 5.7 | 6.9 | 7.5 | 2.4 | 0.4 | 2.5 |
| Costa Rica | 5.9 | 8.8 | 7.8 | 2.6 | -1.1 | 3.5 |
| Cuba | 11.2 | 12.1 | 7.3 | 4.1 | 1.4 | 3.0 |
| Ecuador | 6.0 | 3.9 | 2.5 | 6.5 | 0.4 | 3.0 |
| El Salvador | 3.1 | 4.2 | 4.7 | 2.5 | -3.5 | 2.0 |
| Guatemala | 3.3 | 5.4 | 6.3 | 4.0 | 0.6 | 2.0 |
| Haiti | 1.8 | 2.3 | 3.4 | 1.3 | 2.9 | 2.0 |
| Honduras | 6.1 | 6.6 | 6.3 | 4.0 | -2.1 | 1.5 |
| Mexico | 3.3 | 5.0 | 3.4 | 1.3 | -6.5 | 3.5 |
| Nicaragua | 4.3 | 4.2 | 3.1 | 2.8 | -1.5 | 2.0 |
| Panama | 7.2 | 8.5 | 12.1 | 10.7 | 2.4 | 4.5 |
| Paraguay | 2.9 | 4.3 | 6.8 | 5.8 | -3.5 | 3.0 |
| Peru | 6.8 | 7.7 | 8.9 | 9.8 | 0.9 | 5.0 |
| Dominican Republic | 9.3 | 10.7 | 8.5 | 5.3 | 3.5 | 3.5 |
| Uruguay | 6.6 | 7.0 | 7.6 | 8.9 | 2.9 | 5.0 |
| Venezuela (Bolivarian Republic of) | 10.3 | 9.9 | 8.2 | 4.8 | -3.3 | 2.0 |
| **Latin America** | **5.0** | **5.8** | **5.8** | **4.2** | **-1.9** | **4.1** |
| **The Caribbean** | **4.0** | **7.5** | **3.1** | **0.8** | **-2.1** | **0.9** |
| **Latin America and the Caribbean** | **5.0** | **5.8** | **5.8** | **4.1** | **-1.9** | **4.1** |

*Source*: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures expressed in constant 2000 dollars.
[a] Preliminary figures.
[b] Projections.

3. The economic slowdown cut into labour demand and the unemployment rate rose to around 8.3 per cent for the region overall. The improvements under way in recent years in job quality stopped as the creation of wage jobs in the private sector and of formal employment in general slowed considerably in many countries. Conversely, real wages rose in most of the countries because of lower inflation.

4. The inflation rate dropped sharply from 8.3 per cent in 2008 to around 4.3 per cent in 2009, as a result of falling international prices for some of the commodities included in household consumption baskets, in addition to the effect of currency appreciation and the impact of slacker activity levels on demand.

5. Some positive signals emerged in the second half of 2009, even though financial markets continued to exhibit some volatility and the situation of the global economy still posed some risks. Beyond the short term, however, a number of questions arise as to whether this rapid recovery will develop into sustained growth at the world level and in Latin America and the Caribbean.

6. Given the magnitude of the crisis, it reached every part of the world and the Latin American and Caribbean region was no exception. Yet this crisis differed from those the region had experienced in the past. Not only because the epicentre of the crisis lay in the developed countries, although this plays no small part in accounting for recent economic trends, but, above all, because of the juncture at which the crisis broke out in the region and how the region was affected.

7. First, the combination of highly favourable external conditions and more prudent management of macroeconomic policy had enabled the region to reduce its outstanding debt and to renegotiate it on advantageous terms, while also building up international reserves. The Latin American economies thus went into the crisis with unprecedented liquidity and solvency, which explains why, unlike on past occasions, the countries' financial systems did not deteriorate and there was no flight from local currency, which helped to maintain calm in the region's currency markets. Some of the Caribbean countries, however, had high levels of external borrowing and faced rather more difficult exchange-rate situations.

8. The broadened macroeconomic policy space in many of the region's countries gave them substantial capacity for anti-crisis policymaking. In general, the public policy space was greater in some South American countries. The improved net financial position also afforded renewed access to international financial markets fairly promptly, which further boosted capacity to implement public policies. As a result, even though the downturn in real variables was very sharp, the recovery now looks fairly solid.

9. Although poverty levels in the region remained high, despite the gains made in recent years, and the impact of the crisis on social variables was predictably negative, the deterioration was not as great as had initially been projected, owing to a number of factors. On the one hand, the drop in activity levels and its impact on the labour market were both smaller than expected, so the unemployment rate did not rise as much as the initial contraction had led analysts to fear it would. On the other, international commodity prices, combined with currency appreciation, helped to significantly lower the rate of inflation and limit the erosion of real income, thereby at least partially offsetting the downturn in labour indicators.

10. The rise in social spending in the last few years and the increase in the number and effectiveness of social programmes also played an important role in containing the social costs of the crisis. Learning the lessons from previous crises, the countries sought to maintain — and even expand — the coverage of these programmes, even in the context of a gradually tightening fiscal space.

## II. Recent trends in the Latin American and Caribbean ec

11. In order to understand why the impact of this crisis on Latin Amer Caribbean was different from that of previous ones, it is important to und situation in which the region found itself when the crisis struck. First global economic crisis brought to a sudden end the longest and most int of economic growth that the region had seen in a very long while. A sim of steady per capita GDP growth of over 3 per cent per year (as r 2004-2008) had not been seen for 40 years, since the boom that lasted fr of the 1960s to the oil shock at the beginning of the 1970s, during which posted comparable growth rates for seven consecutive years.

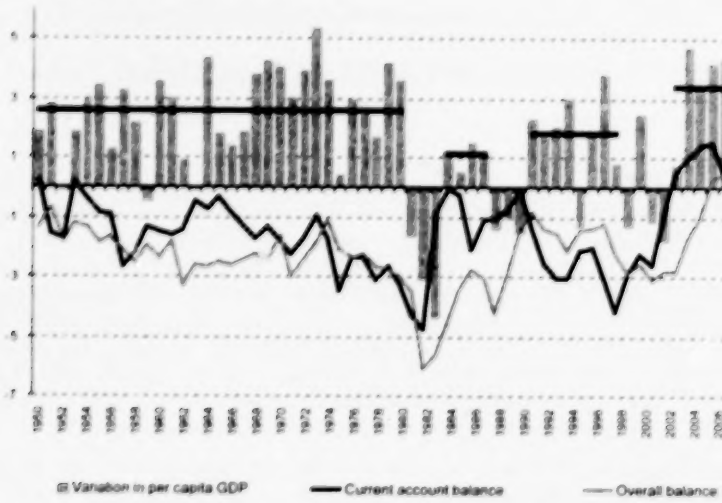
12. As shown in figure I, steady growth was accompanied by quant qualitative improvements in macroeconomic fundamentals, making 20 period of expansion unprecedented in the region's recent history. On the the region enjoyed a current account surplus (largely generated by impr the terms of trade, especially in South America) as well as increasing flows from migrant workers (mainly in Mexico and, above all, Central Meanwhile, ever-larger primary surpluses were being posted on the publi and the region's overall deficit was drastically reduced (even turning int in 2006-2007).

13. At a time of abundant liquidity in international financial markets, account surplus allowed countries to reduce their external debt burde renegotiate more advantageous terms, as well as to accumulate reserv fiscal slack, meanwhile, made it possible to slash public debt.

Figure I

**Latin America and the Caribbean: variation in per capita GDP, current balance and overall balance**

(Percentages of GDP)



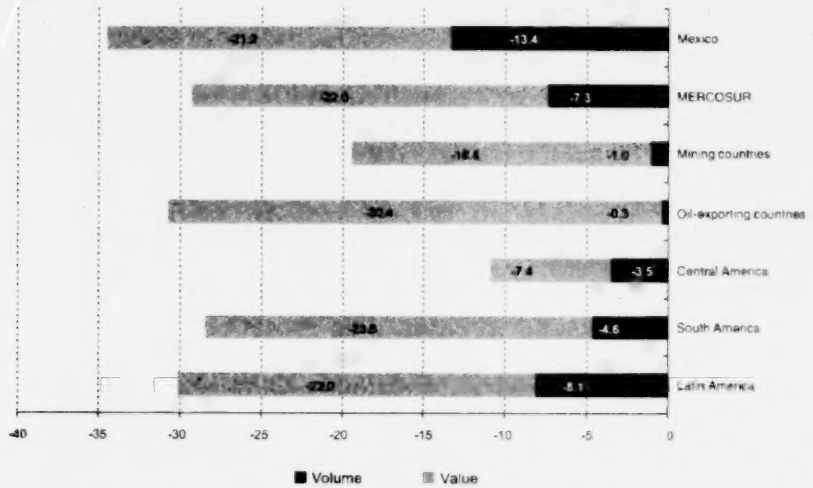

*Source*: Economic Commission for Latin America and the Caribbean (ECLAC), on the official figures.

14. Although the crisis imposed heavy constraints on macroeconomic policy as it plunged the economies back into deficit positions on their external and public accounts, their favourable situation in terms of financial stocks (more assets, fewer and better liabilities) meant that in 2009, they did not have to contend with problems in the domestic financial systems, runs against domestic currencies or difficulties meeting their external obligations. All this helps to explain why this time around the strongest effects of the crisis were channelled not through the financial sector but through the real economy.

## A. Channels of transmission of the crisis

15. As noted above, the repercussions of the crisis on Latin America and the Caribbean were channelled through the real sector, damaging what had been in recent times one of the main engines of regional growth.

Figure II
**Variation in goods exports, free on board (FOB), by volume and value, 2009**
(Percentages)




*Source*: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

16. Exports plummeted as of the second semester of 2008, both in volume and value terms. Even though the fall slowed in the second half of the year, Latin American export volumes fell by an estimated 8.1 per cent in 2009. As had been expected, Mexico's exports suffered the most, sliding by about 13.4 per cent in real terms. Export volumes are estimated to have dropped by about 3.5 per cent and 4.6 per cent in Central America and South America, respectively, as shown in Figure II.

17. The slowdown in economic activity worldwide, together with the drop in international trade flows, had a negative impact on commodity prices, which hurt the region's terms of trade. Although the downtrend in international commodity prices bottomed out at the beginning of 2009, average price levels for the year were far lower than in 2008, which suggests that the terms of trade for the region as a whole worsened by an estimated 6.0 per cent. This had implications mainly for

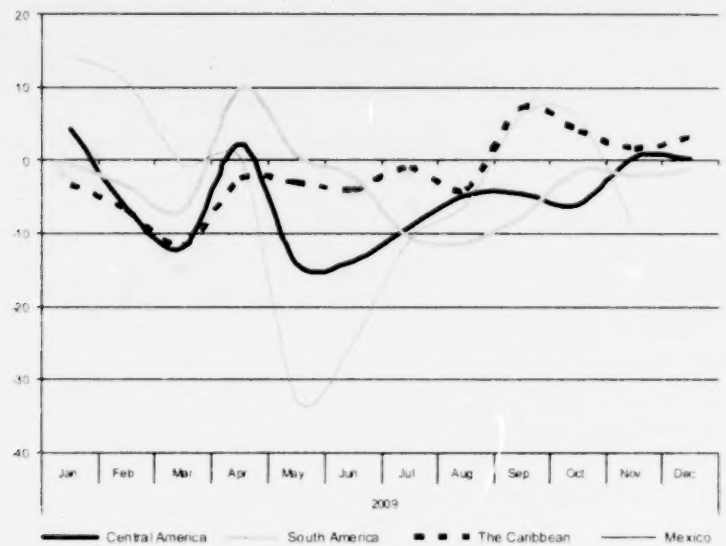
South America, and for the oil, hydrocarbon and metal producers in particular, as well as, albeit to a lesser extent, for countries that specialize in food production. In Central America, however, which imports those commodities, terms of trade improved, although not enough to fully offset the worsening experienced in previous years.

18. As shown in figure III, tourism, which is of major importance to the economies of the Caribbean and Central America, declined sharply. The contraction was particularly notable in Mexico in the second quarter of the year due to the outbreak of influenza A (H1N1). Overall, the downturn in tourism was estimated at between 3 per cent and 6 per cent in 2009.

Figure III

**Latin America and the Caribbean: year-on-year variation in international tourist arrivals, 2009**

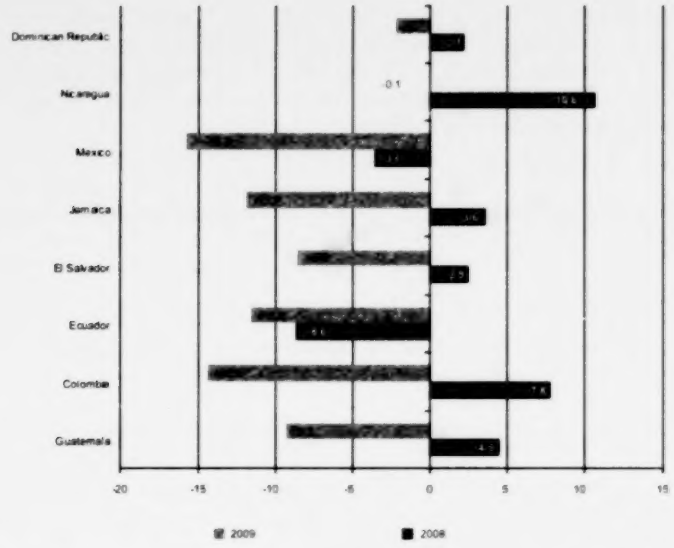
(Percentages)




*Source*: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from World Tourism Organization (UNWTO).

19. Given that the main destinations of most Latin American and Caribbean emigrants are the United States and Spain, two of the countries worst hit by the crisis, remittances to the region plummeted. Annual falls of close to 10 per cent in remittances were recorded in some Central American countries, such as El Salvador and Guatemala, and even larger drops in Colombia, Ecuador, Jamaica and Mexico. The Dominican Republic and Nicaragua experienced smaller declines.

Figure IV
**Latin America and the Caribbean: year-on-year variation in remittances from migrant workers, 2008 and 2009**
(Percentages)



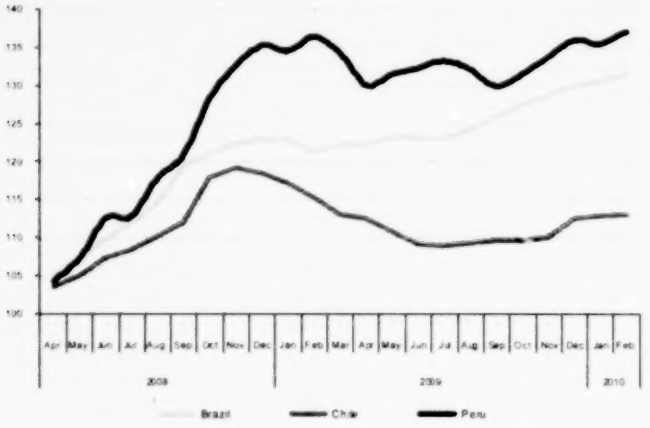

*Source*: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

20. Meanwhile, FDI in the region fell by an estimated 39.1 per cent, by far the largest drop for at least 30 years. Between 1999 and 2003, FDI flows fell by about 47 per cent, but then the drop was concentrated in only two countries (Argentina and Brazil), while this time around, the downturn was spread across the region, although diminished flows to Brazil accounted for a significant proportion of the total decline.

21. Although the impacts of the international crisis were felt mainly through the channel of the real economy, in some cases there were impacts on financial systems that may have had significant repercussions on activity levels. Having said that the turbulences in the region were mostly related to trade rather than reversals of capital inflows, there were three major exceptions: Brazil, Chile and Peru, whose financial systems were more exposed than those of the rest of the region in late 2008.

22. As shown in figure V, the manifestation of this situation in these countries' financial systems was a major contraction in private bank credit in real terms. The public banks then played an active role in many countries as part of countercyclical strategy although, with the exception of Brazil (where public banks account for a large proportion of total credit), the capacity to offset the contraction in private bank credit was fairly small.

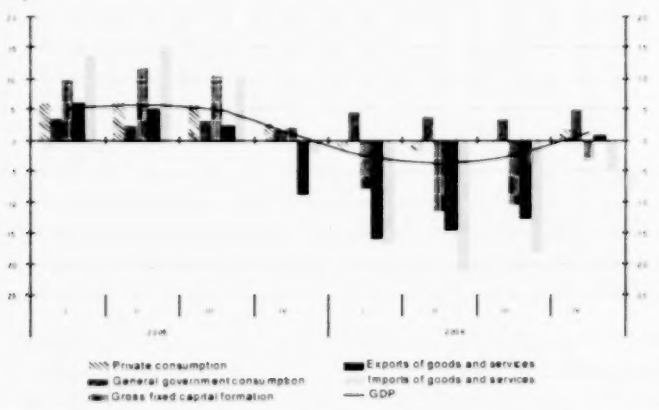
Figure V
**Brazil, Chile and Peru: private bank lending 2008, 2009 and 2010**
(Index: first quarter 2008=100)




*Source*: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

23. The expectations of consumers and businesspeople alike worsened, especially towards the end of 2008 and at the beginning of 2009, which translated into lower levels of both private consumption and investment. In fact, as shown in figure VI, public consumption was the only type of consumption to increase in the first part of the year when many countries in the region had at least some room to implement countercyclical policies. These policies partially offset the negative performance posted by the other components of domestic demand and helped speed up the recovery in the second part of the year.

Figure VI
**Latin America and the Caribbean: breakdown of total supply and demand, 2008 and 2009**
(Percentages)




*Source*: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

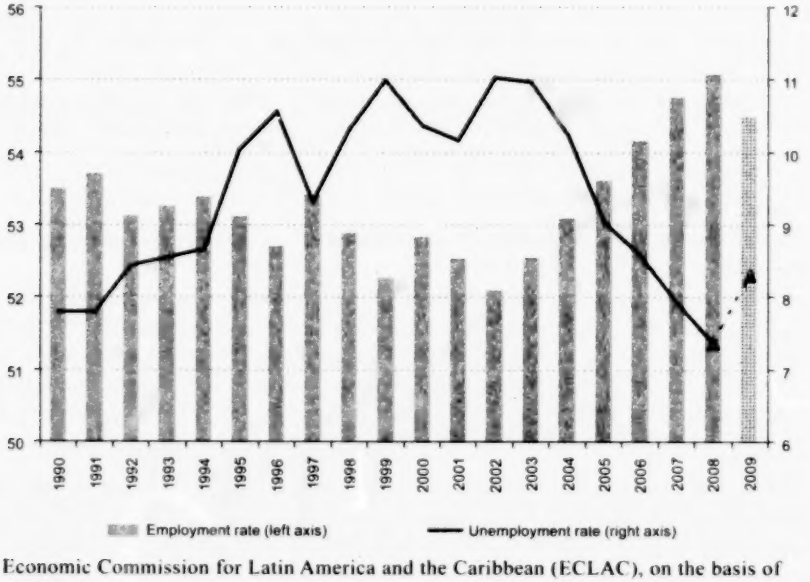
## B. The social effects of the crisis

24. The sudden slowdown in economic growth had a negative impact on the labour market: the employment rate fell for the first time in six years. Unemployment rose by around one percentage point from 7.4 per cent to 8.3 per cent (see figure VII). The slack labour supply, as indicated by the participation rate, averted a larger rise in unemployment.

25. The improvements under way in recent years in job quality stopped as the creation of wage jobs in the private sector and of formal employment in general slowed considerably.

26. At the same time, the Latin American and Caribbean countries took steps to implement social measures. Regionwide, 26 countries have announced measures to support poor families and 18 to subsidize consumption. Accordingly, the portfolio leans slightly towards support for poor families (57 per cent). A breakdown of the measures by subregion, however, shows a major difference in portfolio composition. In South America and Mexico, three quarters of the measures announced involve support for poor families, while in Central America and the Caribbean countries the distribution is fairly balanced.

Figure VII
**Latin America and the Caribbean: rates of employment and unemployment**
(Percentages)




*Source*: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

27. The crisis contributed to the lowering of regional inflation from 8.3 per cent in 2008 to 4.3 per cent in 2009. This was the result of the dual impact of the global recession and the decline in trade on food and energy prices, on the one hand, and of the widening of the gap between real and potential GDP brought about by the regionwide drop in demand, on the other.

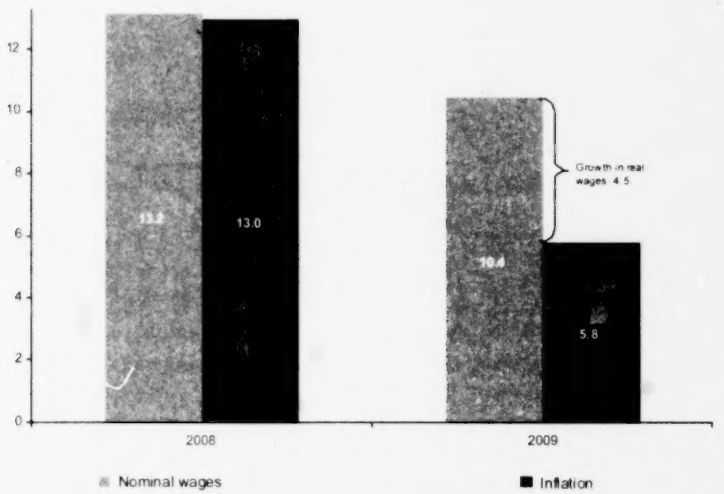
28. Lower inflation staved off a fall in real wages, which partly explains why the negative impact on poverty was more moderate than initially projected, as shown in figure VIII.

29. The smaller-than-expected increase in poverty can also be attributed to the social spending policies implemented by most of the countries of the region, especially to those deployed by the larger countries that have a more tightly woven institutional fabric, which enables them to implement strategies that, by being more targeted, tend to be more effective during crises than the general subsidies on consumption of certain goods and services. Generalized subsidies tend to be the instruments most commonly used in some Central American and Caribbean countries whose institutional framework is weaker.

Figure VIII

**Latin America: variation in nominal wages, inflation and real wages**[a]

(Percentages)




*Source*: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

[a] Simple average for 10 countries.

# III. Macroeconomic policy

30. Many countries in the region were able to implement countercyclical policies that allowed them not only to at least partially offset the negative evolution of most of the components of domestic demand, but also to speed up the recovery process, which took hold in some countries as of the second quarter and in nearly all by the third quarter of 2009.

31. One characteristic feature of the crisis has been the capacity shown (by some countries more than others) to implement macroeconomic and sectoral policies to mitigate the negative effects of the crisis on economic activity and employment. To varying degrees, according to the type of problem faced and, above all, according to each country's capacity (in not only financial, but also institutional terms) to deploy

public policies, the Governments of the region have introduced a wide array of initiatives which can broadly be grouped into the following categories: fiscal measures; monetary, financial and exchange measures; and social and employment measures.

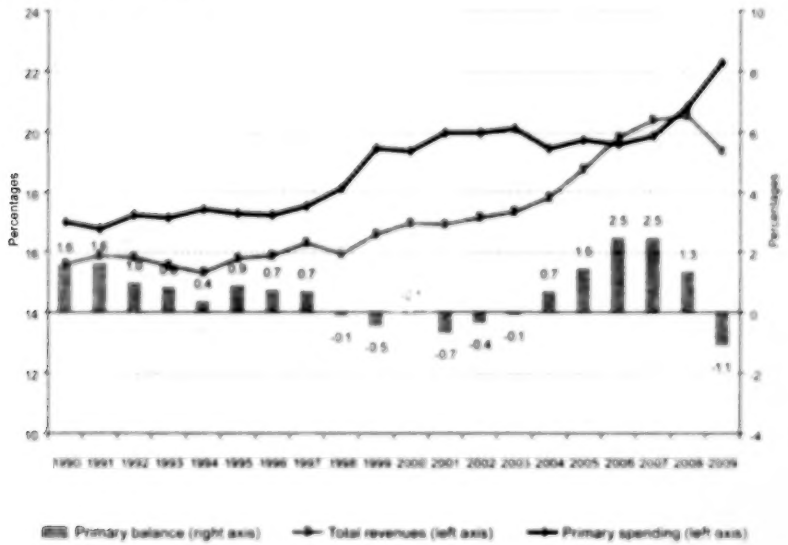
## A. Fiscal policy

32. The positive stimulus of fiscal policy action was one of the distinctive features of economic management in 2009. The region's primary balance fell from a surplus equivalent to 1.4 per cent of GDP in 2008 to an estimated deficit of 1.1 per cent of GDP in 2009. This drop of more than two GDP points, which is a measure of the size of the fiscal stimulus, reflects both the decline in public revenues and the increase in public expenditures, including both current and capital spending (see figure 9).

Figure IX

**Latin America: revenue, primary spending and primary balance, 1990-2009**

(Simple average, percentages of GDP)




*Source* Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

33. Revenues have been conditioned by economic growth (which in turn has influenced tax receipts) and by the fall in the prices of the commodities that the region exports and that in some countries account for a high proportion of public revenues.

34. In addition to these exogenous factors, in many cases, policy measures taken in association with anti-crisis strategies to stimulate domestic demand have reduced tax receipts. Income tax rebates and other tax benefits for both companies and private individuals are among the most widely used instruments, having been introduced in 12 of the 19 countries of Latin America.

35. Countries responded to the crisis with a broad range of measures that sought mainly to strengthen aggregate demand and offset the regressive social effects on the more vulnerable sectors of either the crisis itself or the adjustment measures that may have been taken. The fiscal measures adopted vary widely, given the different capacities each country has to manage and execute them, and depending on the availability of resources. The measures announced may be grouped into two categories of instruments: (i) measures involving tax systems and (ii) measures involving fiscal spending. Table 2, below, provides a schematic view of the wide range of government measures. On the income side, these run the gamut from changes to the income tax structure, through adjustments to the tax base (deductions, exemptions or accelerated depreciation systems) or to nominal tax rates, to reform of taxes on goods and services (VAT, specific taxes or tariffs). On the spending side, the measures sought mainly to boost investment in infrastructure, housing, programmes to support small and medium-sized enterprises (SMEs) and small farmers, or financed a variety of social programmes.

Table 2
**Latin America (19 countries): main fiscal measures announced to combat the effects of the crisis**

| | Argentina | Bolivia (Plurinational State of) | Brazil | Chile | Colombia | Costa Rica | Ecuador | El Salvador | Guatemala | Haiti | Honduras | Mexico | Nicaragua | Panama | Paraguay | Peru | Dominican Republic | Uruguay | Venezuela (Bolivarian Republic of) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Tax system** | | | | | | | | | | | | | | | | | | | |
| Corporate income tax (cuts/depreciation) | | | X | T | X | T | X | | X | | | T | X | | | | X | T | |
| Personal income tax (cuts) | X | | X | T | X | | X | | X | | X | T | X | X | | | X | | |
| Foreign trade taxes | X | X | T | | | | X | | | | | X | T | | T | | X | X | |
| Taxes on goods and services | | | T | | | X | X | | | | | X | | | | | | X | X |
| Social contributions | X | | | | | | | | | | | T | | | | | | | |
| Others | | | X | T | X | | T | | | | | | X | | | T | X | X | |
| **Public spending** | | | | | | | | | | | | | | | | | | | |
| Investment in infrastructure | X | X | X | X | X | X | X | | X | | X | X | X | | X | X | X | X | |
| Housing | X | X | X | T | | X | X | X | X | | X | X | X | | X | X | X | X | |
| Support for SMEs or agricultural producers | | X | X | X | X | X | X | X | X | X | X | X | | X | X | X | X | X | X |
| Support for strategic sectors | T | X | X | X | X | | | | X | | X | X | | | | X | | X | |
| Direct transfers to families | T | X | | T | | X | | X | | | X | X | X | X | X | | | | |
| Other social programmes | X | | X | X | X | X | | X | X | X | X | X | X | X | X | X | X | X | |
| Other spending | | | X | | X | | | | | | | | | X | | | | | |

*Source*: Economic Commission for Latin America and the Caribbean (ECLAC), *The reactions of the Governments of the Americas to the international crisis: an overview of policy measures up to 31 December 2009* (LC/L.3025/Rev.5), Santiago, Chile, 31 January 2010.
*Note*: T= Temporary measures.

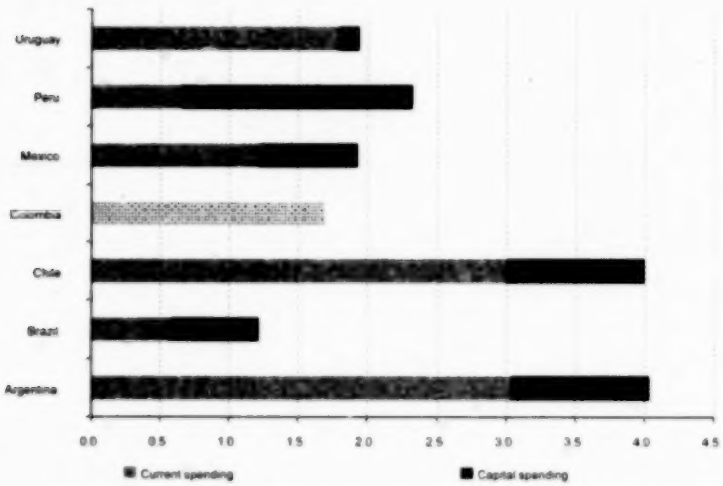
36. However, falling fiscal revenue, tight credit conditions and limited capacity in some countries to execute investment projects have delayed implementation of many of these measures.

37. The Governments in the region also announced fairly ambitious spending plans. As far as their implementation is concerned, in most of the countries for which information on actual spending is available for up to the third quarter of the year, current expenditures (which can generally be stepped up more quickly) increased significantly in the first half of the year, while capital expenditures (which are usually slower to materialize) did so to a lesser extent. The drop in commodity prices reduced the fiscal space available in some of the countries that are highly specialized in commodities, however, which prevented them from implementing countercyclical measures. This occurred in the Bolivarian Republic of Venezuela, where the drop in fiscal revenues compelled the authorities to take steps to contain public spending, which gave fiscal policy a procyclical start.

Figure X

**Latin America (selected countries): variation in public expenditure, 2008-2009**

(Percentages of GDP)




*Source*: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

## B. Monetary and exchange-rate policies

38. As soon as the crisis broke out, the central banks of the region adopted a series of wide-ranging measures aimed at procuring either recovery or the liquidity of local financial markets, or both. The widespread fall in inflation freed up monetary policy both in countries that run inflation-targeting schemes and those that use other targets, such as certain monetary aggregates.

39. The substantial lowering of monetary policy rates by most of the region's monetary authorities occurred most quickly in the countries with inflation-targeting

schemes. In many cases, however, although interest rates plummeted, inflation rates fell even faster, cancelling out in real terms the effect pursued by policy action.

40. Also, the central banks' efforts to inject more liquidity into the financial system failed to translate into an increase in credit in the private banking sector. As noted earlier, in response to this situation, public banks in many countries of the region were engaged in government countercyclical strategies and stepped up public lending to compensate, in some cases partially, in others totally, for the tighter stances of private banks. The impact of this instrument depends on the magnitude of the official banking sector in the financial system. Hence, it has been very significant in Brazil, where public bank lending represents around 35 per cent of total credit.

41. As far as exchange rates are concerned, once the strain experienced at the end of 2008 (which in some cases lasted into the beginning of 2009) was over, the general trend in South America was a return to the appreciation of local currencies under way prior to the crisis. The search for higher returns during a time of abundant liquidity in the international market, together with the relatively robust performance of many of the region's economies, resulted in large inflows of capital that pushed down the exchange rate in most of South America. The notable exception has been Mexico, where the exchange rate is 22 per cent higher in real terms than it was before September 2008 when the international crisis unfolded.

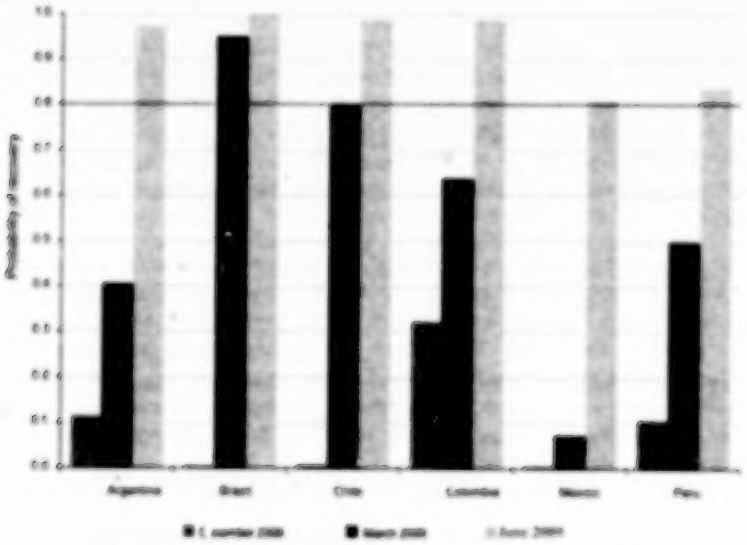
42. In order to defend the real exchange rate to some extent and to sustain domestic liquidity levels, many central banks intervened in the exchange market, which in some cases enabled them to restore international reserve levels to those seen prior to the last quarter of 2008. One notable example is Brazil, where international reserves rose by 23.1 per cent to over US$ 44.737 billion and the real exchange rate fell by 25.9 per cent between December 2008 and December 2009.

43. The changes observed in the countries' international reserve positions over 2009 are particularly interesting. Brazil recorded a larger increase than that posted by Latin America and the Caribbean as a whole, which masked an uneven situation across the region: in some countries, the increases in reserves were enough to offset the losses observed at the end of 2008, while in others, such as Argentina and Mexico, the increments had a minimal impact on the total regional rise. It should be noted that in some cases, especially in the smaller economies, such as those of the Caribbean, the expansion of reserves was mainly the result of the recent allocation of Special Drawing Rights by the International Monetary Fund.

## IV. The recovery of the Latin American and Caribbean economies in the second half of 2009

44. According to the leading indicators calculated by ECLAC using the methodology presented in ECLAC (2009a), six of the largest economies of the region, Argentina, Brazil, Chile, Colombia, Mexico and Peru, which together account for about 90 per cent of regional GDP, were on the road to economic recovery in the third quarter of 2009 (see figure XI).

*Figure XI*
**Latin America (selected countries): leading indicators**
(Probability of recovery)




Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

45. Expectations that the downturn witnessed in economic activity between the fourth quarter of 2008 and the second quarter of 2009 would be reversed were consistent with the improvements detected in the analysis of the latest information on most of the variables for the real economy.

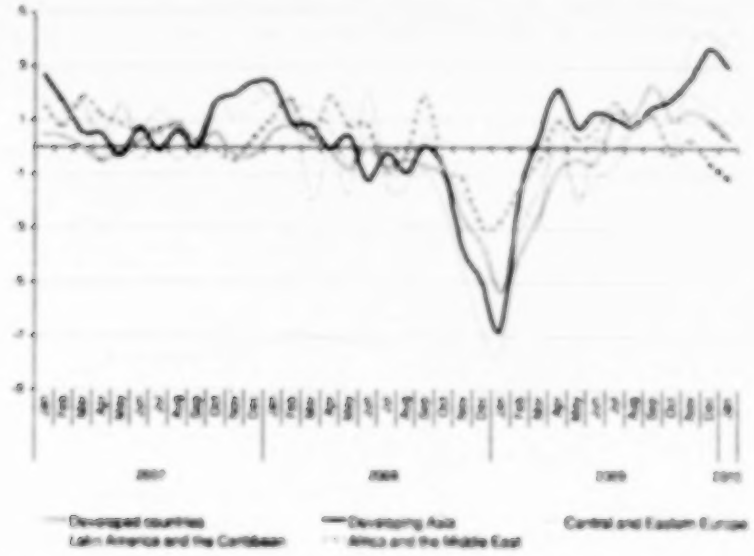
46. Export volumes began to expand again as of the third quarter of 2009 (see figure XII), while the increase in global economic activity and international trade is having a positive effect on demand for commodities and has been pushing up commodity prices since the second quarter of 2009. This is, in turn, reversing the worsening of the region's terms of trade, which are expected to improve by 4.1 per cent in 2010 for the region as a whole, and by even more in the hydrocarbon- and metal-exporting countries of South America and in Mexico. The terms of trade of Central America, in contrast, are projected to worsen (see figure XIII).

47. With regard to remittance flows, the onset of economic recovery in the United States of America and Spain, the two main destinations for Latin American and Caribbean emigrants, adds weight to expectations of a recovery in that category of foreign-exchange inflows to the region.

Figure XII

**Variation in trade volume (average volume of imports plus exports), by region[a]**

(Percentages)



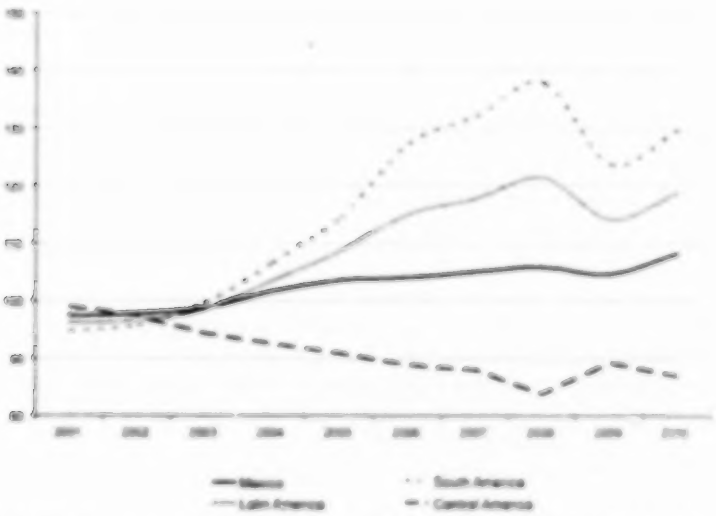
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of the Central Plan Bureau (CPB), Netherlands Bureau for Economic Policy Analysis.

[a] Three-month moving average compared with the previous quarter.

Figure XIII

**Latin America: terms of trade, 2001-2010**

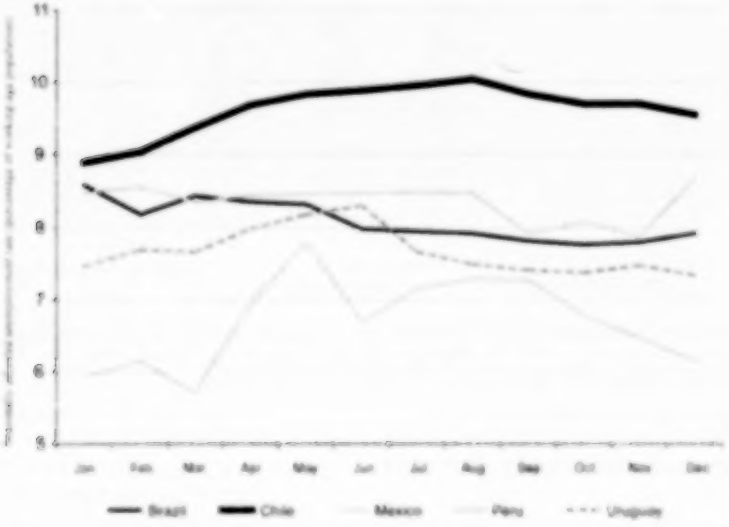
(Index 2000=100)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

48. In some countries, domestic demand continued to receive fiscal stimulus in the second half of 2009 which, along with the factors mentioned earlier and as a result of a gradual return to normalcy in financial markets, often with the additional support of official banks, led to a recovery — at fairly rapid rates, in some cases — which was reflected in the gradual improvement in labour-market indicators for the region (see figure 14).

Figure XIV
**Latin America (selected countries): seasonally adjusted monthly unemployment rates, 2009**
(Percentages of working-age population)




*Source*: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

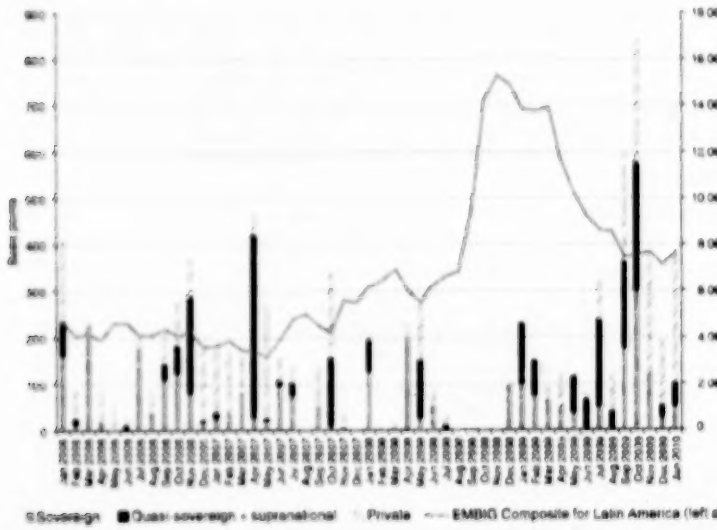
49. At the same time, the increased tolerance for risk in a context of high liquidity in international financial markets — along with a positive perception of prospects for several of the economies in the region — resulted in a number of countries regaining access to international credit. This had a positive effect on stock markets (see figure XV) which began to return to levels seen prior to the worsening of the crisis.

50. By December 2009, a total of US$ 65 billion in sovereign and corporate bonds had been issued by the region on international markets: more than either the total for 2008 (US$ 19 billion) or the average for 2006 and 2007 (US$ 42 billion annually). The surge in corporate bond issues had a strong hand in this high total figure (see figure XVI).

Figure XV
**Stock market indicators: Dow Jones and emerging markets**
(Index 2000=100)

*Source*: Economic Commission for Latin America and the Caribbean (ECLAC), on
figures from Bloomberg.

Figure XVI
**Latin America and the Caribbean: EMBIG[a] and external bond issues**
(Basis points and millions of dollars)




*Source*: Economic Commission for Latin America and the Caribbean (ECLAC), on
figures from JP Morgan.
[a] Emerging Markets Bond Index Global.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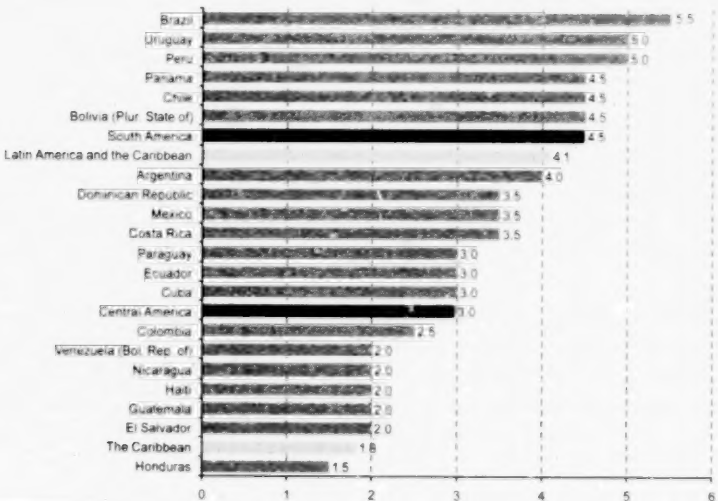
51. In turn, the private sector should be able to restructure assets and lending activity should return to normal which, together with the gradual improvement in labour market indicators and the renewed confidence within the private sector, as indicated by surveys of business and consumer expectations, should sustain a recovery in domestic demand for both consumer and capital goods.

# V. Prospects, risks and challenges facing the region

52. Given the speed of the recovery that became evident in the second semester of 2009, in 2010 the region could return to growth rates that, in some cases, will come close to matching those seen prior to the crisis. While this is the most likely scenario, it is not without risks. Moreover, there are doubts as to whether this recovery will lead to sustained growth.

53. The projected growth rate for 2010 is 4.1 per cent, with expectations of stronger growth in South America than in the other subregions, given the larger size of the domestic markets in some of the countries (particularly Brazil and, to a lesser extent, Argentina and Colombia), the diversification of export markets, and the greater role played by Asia, China, in particular, as export markets for a number of countries (Argentina, Brazil, Chile and Peru). By contrast, slower growth is expected in more open economies that have a less diversified portfolio of trading partners and are more heavily reliant on manufacturing trade, such as Mexico and the Central American economies. The Caribbean economies may be similarly placed and many face additional difficulties arising from a complex financial and exchange-rate situation (see figure XVII).

Figure XVII
**Latin America and the Caribbean: growth rates, 2010**
(Percentages)



54. In this context of increased growth and higher prices for a number of commodities in which the region specializes, there is reason to expect a rise in public revenues and, to the extent that private sector demand increases, a gradual decline in government consumption throughout the year. In countries that specialize more heavily in natural-resource-intensive processed goods, however, higher fiscal revenues will boost the Governments' capacities to inject impetus into domestic activity. Capital expenditures, responding more slowly, will continue to increase as a result of various projects initiated in 2009. This should not prevent an improvement in the fiscal balance, however.

55. To the extent that growth takes hold and approaches potential growth rates, inflation could begin to edge up, which could lead to a tightening of monetary policy, perhaps towards the end of the year. Here, however, central banks will again face the choice between maintaining price stability and limiting currency appreciation, in an environment in which exchange rates will very probably be subject to downward pressure (currency appreciation) owing to a surplus of hard currency resulting from abundant international market liquidity.

56. While there is reason to expect a deterioration in the balance-of-payments current account compared to 2009, mostly as a result of an upturn in imports, the availability of external financing, together with increased FDI inflows, will probably suffice not only to cover this larger deficit, but even to continue restoring international reserve levels.

57. Economic growth should help to increase rates (and, probably, the quality) of employment, although it will likely mean a corresponding increase in the participation rate, which will partially offset the impact on unemployment. All in all, it is estimated that unemployment could fall to around 8 per cent, settling mid-way between pre- and post-crisis levels. This, in turn, would have a positive effect on poverty indicators.

58. Beyond the problems that persist in some economies of Eastern Europe, it remains to be seen whether the developed economies will be able to grow as they phase out the substantial stimulus initiatives associated with the countercyclical policies implemented in the United States and Europe. Together with the increase in unemployment and the still volatile international financial market, this raises questions about the strength of the recovery that began in 2009.

59. As noted earlier, expansionary monetary policy, led by the world's principal central banks, with the emerging economies following suit, led to historically low interbank interest rates. This greater liquidity, however, was not reflected in increased credit to the private sector, which has been slowing in much of the world, and even declining in year-on-year terms in the United States and the euro area.

60. The credit squeeze is the result of a combination of factors limiting both supply and demand, associated with the fall in economic activity and the loss of wealth experienced by economic agents, most notably towards the end of 2008. Since then, banking institutions have been focusing on shoring up their balance sheets and reducing their exposure, and are maintaining greater liquidity in order to deal with potential problems. The banks' more conservative stance is compounded

61. The challenge facing the global economy is how to leverage credit to speed up the recovery, particularly with regard to financing consumption and SMEs, at a time when the public sectors of many developed countries will have greater need for financing to cover the massive deficits built up by their fiscal stimulus measures.

62. This situation creates a tension between the need to maintain the policy stimulus if private sector demand is slow to pick up, and the increasing problem this creates in terms of availability of credit for businesses and consumers, as well as the burden of financing the enormous deficits accumulated in some countries. All of this must be considered against a backdrop of continued supply constraints due to uncertainty and the bias towards liquidity that are still evident in financial markets.

63. The other major risk is that concern over the need to progressively close fiscal gaps will take precedence over other policy objectives, and that this will lead to a premature withdrawal of fiscal and monetary stimulus measures that, at least thus far, have been the principal factors buttressing demand, and the main (in some cases the only) engine driving economic recovery.

64. It is highly probable that the crisis will lead to profound changes that will produce a less growth-friendly international environment than the conditions the region experienced between 2003 and 2008. One factor is that the post-crisis world is likely to see slower overall growth, given the drop in aggregate demand in the developed countries, counterbalanced in part by rising overall demand in the developing countries.

65. As a result, the emerging economies may be expected to play a stronger role in world growth, but within the framework of a slowdown in trade flows. The drop in demand for imports among developed economies will mean that emerging economies will have fewer opportunities to place their products in those markets, which will exacerbate competition and encourage the adoption of domestic-market-oriented strategies, at least in the larger economies. At the same time, this shows up the need to redefine patterns of production and trade specialization and encourage innovation, the building-in of knowledge and product diversification, on the one hand, and to build up a highly diversified portfolio of destination markets, with many in Asia, on the other.

66. The global financial crisis has also highlighted the need to reform the international financial architecture and, in particular, regulatory and oversight systems, in order to ensure greater international financial stability. Though it is clear that the reform impetus is weakening as the global economy recovers, it may be expected that a new, more transparent banking model will be developed, with less incentive for risk-taking and lower levels of leveraging. This could lead to a reduction in international financial flows and, therefore, a partial reversal of the pattern of financial integration seen prior to the crisis.

67. Although it is not yet clear how these factors will affect interest rates in general, there is a risk they will rise, given projections of steadily mounting public debt in some developed countries and the lack of any tax or fiscal reform that might lead to lower demand for resources on the part of those countries' public sectors. Nevertheless, this situation could change, insofar as awareness increases of the risks to growth, fiscal reforms are put in place and saving rates begin to rise.

given the greater caution prevailing in the wake of the financial crisis and the possibility of regulatory changes that could limit risk-taking. This could deepen the differences among developing countries in terms of access to the international capital markets, which would oblige less well-endowed or more macroeconomically vulnerable countries to rely more heavily on financing from multilateral agencies or on more expensive financing under less advantageous conditions.

69. The question then arises as to how the region can make further inroads in a world characterized, on the one hand, by lower growth rates in the developed countries and developing countries playing a larger role in global growth, and, on the other, financial systems that are subject to stricter regulations and oversight, with less dynamic credit markets and higher interest rates? How, moreover, is this to be accomplished in a way that allows for sustained growth at rates that will make it possible to meet social needs, while at the same time providing for more equitable distribution of the benefits of that growth?

70. The recovery from the crisis seems to have been quicker than expected, largely thanks to the domestic strengths built up by the countries of the region as a result of sounder macroeconomic policies. Upturns in several of the factors that drove demand in the years prior to the crisis, coupled in many cases with strong impetus from public policies, should enable a rapid recovery in the context of substantial idle capacity. But how can that recovery be transformed into a process of sustained growth beyond 2010?

71. Answering these questions satisfactorily is well beyond the scope and ability of this document, which merely offers a brief discussion of the role of public policies in this connection. Aside from differences from country to country, the Latin American and Caribbean economies have certain features in common that underscore the importance of State involvement. In the short term, the countries of the region acted to offset the effects of the crisis to the best of their capacities — in the process revealing major differences in terms of this capacity. But the objective of regaining a sustained growth path poses fresh and more complex challenges. For this reason, the Latin American and Caribbean countries face the unavoidable task of generating and expanding the policy space, for which they must (with few exceptions) increase the resources available for financing policies, create instruments and strengthen their institutions, particularly those involved in coordinating different policy areas.